PROVINCIAL FINANCE
IN INDIA

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PREFACE

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CHAPTER I

THE PRESIDENCY SYSTEM

The acquisition of territories in India was made piecemeal by the East India Company. By the time the British merchants in India found themselves in possession of some measure of political authority, three Presidencies had grown up in different parts of the country. These Presidencies were practically independent of one another in financial as well as administrative matters. They were all subject to the authority of the Court of Directors of the Company in England, and each of them had direct relations with that body. In 1773, the Regulating Act gave Bengal a position of ascendancy over the other Presidencies, when the title of Governor-General was conferred on the administrative head of that province. Though he was not made the Governor-General of India, he was given the power, in concurrence with his Council, of superintending and controlling the other Presidencies in the matter of declaration of war or commencement of

hostilities.[1] The Presidency Governments were further required to transmit constantly and diligently to the Governor-General and Council of Bengal information on all transactions and matters relating to the government, revenues, or interests of the Company.[2]

By Pitt's India Act of 1784, the Government of Bengal was designated as the Supreme Government.[3] The powers of the Governor-General and Council were also enlarged, to some extent, under its provisions.[4] The Charter Act of 1793, while it vested the government and management of territorial acquisitions and revenues of the Presidencies of Madras and Bombay in a Governor and three Councillors each, invested the Governor-General of Bengal in Council with full power and

[1] Any President and Council of Madras, Bombay, or Bencoolen, who offended in any of these cases was made liable to be suspended by order of the Governor-General and Council. They were directed to pay due obedience to such orders as they might receive, touching the premises, from the Governor-General and Council.

[2] Section 9.

[3] Section 18.

Section 31 of Pitt's India Act runs as follows:

And be it further enacted that the Governor-General and Council of Fort William aforesaid shall have power and authority to superintend, control and direct the several Presidencies and Governments now or hereafter to be erected or established in the East Indies by the said United Company, in all such points as relate to any transactions with the country powers, or to war or peace, or to the application of the revenues or forces of such Presidencies and settlements in time of war, or any such other points as shall, from time to time, be specially referred by the Court of Directors of the said Company to their superintendence and control.

authority to superintend, control and direct the several Presidencies of Fort St. George and Bombay and all other Governments, in all such points as might relate to any negotiations or transactions with the country powers, or levying war, or making peace, or the collection or application of the revenues, or the military or civil government of the Presidencies or territories.[1] It was further provided that the Presidency Governments were to be bound to obey the orders and directions of the Governor-General in Council, in all cases whatsoever, except only where they should have received positive orders and instructions from the Court of Directors or the Board of Control to the contrary.[2]

The powers entrusted to the Governor-General in Council by these provisions were of a somewhat indefinite character, and might be interpreted to give him complete control over the other Presidencies. Probably this was the intention of Parliament. But in practice, as was observed by the Court of Directors, the Supreme Government made little exercise of its superintending authority, and even that little exercise of it was generally made " when it was too late to be made with real effect, namely, after the subordinate Government had taken its course, thus losing the character of

[1] Section XL of the Charter Act of 1793.

[2] Section XLI.

control and responsibility, and retaining only that of *ex post facto* intervention—a sort of intervention always invidious, and in most cases nothing but invidious, because what was really done, however open to censure, was beyond the reach of recall or correction."[1]

✓Till the year 1833, the financial system of the three Presidencies remained, to some extent, distinct and separate. The Governments of Madras and Bombay were largely independent of the Government of Bengal in the exercise of their financial authority. The Governor-General in Council in the case of Bengal, and the Governor in Council in Madras or Bombay, possessed the power to levy taxes and duties and to incur necessary expenditure, subject to the direction and control of the Court of Directors and the India Board. There was no authority on the part of the Governor-General in Council of Bengal to impose any taxes on the other Presidencies. Considerable divergences existed in respect of methods of taxation and financial procedure in the three Presidencies. For the purpose of presentation to Parliament, statements were prepared showing the accounts of India as a whole as well as the separate accounts of the different Presidencies. It is not clear whether the income

[1] *Despatch from the Court of Directors, dated the 10th December, 1834, paragraph 82.*

derived from the entire country was regarded as one fund ; but the revenues of one Presidency were often employed in meeting deficits in the other Presidencies.

A few words may here be said about the financial situation in each of the three Presidencies. The annual revenue and expenditure of Bengal, on an average of the six years which followed the acquisition of the *Diwani*, were £2,202,207 and £1,504,934 respectively. The accounts of the Madras Presidency during this period were as follows : average annual revenue, £405,191 ; expenditure, £595,920. The accounts of Bombay were on a still smaller scale, namely, average annual revenue, £76,057 ; expenditure, £306,391. It will thus be seen that while substantial surpluses were realised in Bengal, both Madras and Bombay had large deficits. The Bengal surpluses were utilised in making good the deficiencies of the other Presidencies, in meeting the expenditure incurred in Bencoolen and St. Helena, and in purchasing investments. The result was that, although the income of the province was large, the financial position of Bengal was prevented from becoming strong. In fact, the annual drain on her resources began gradually to undermine her financial position. In 1768, Governor Verelst wrote : "The great demands which have been made on this Presidency from every quarter have reduced the treasury to a very low state, and

alarm us for the consequences which must inevitably attend such a vast exportation from this country."

In 1770, Bengal was visited by one of the most dreadful famines known to history, but the revenue realisations of this year did not fall much below those of the previous year. The financial positions of the different provinces during the next eight years may be gathered from the following annual averages : Bengal,—revenue, £2,626, 519 ; expenditure, £1,435,789 ; Madras,—revenue, £496,476 ; expenditure, £468,390 ; Bombay,—revenue, £169,452 ; expenditure, £396,451. In each of these eight years there was a large surplus in Bengal, the total amount of the surpluses being over eight and a half million pounds sterling. In Madras, surpluses were realised in six of these years, while two of them exhibited deficits, the net result being a small surplus of £224,710. The position of Bombay was throughout this period one of recurring deficits, the total amount of which was no less than £1,814,890. The deficiency was made good by means of aids received from Bengal, which came up to a total of £1,852,527.[1]

The administration of Bengal was, during all these years except the first, under the control of Warren Hastings. The remaining period of

[1] *Fourth Report of the Committee of Secrecy, 1782.*

Hastings's administration was one of financial difficulty. This was due to a large increase in expenditure and a substantial diminution in income. Bengal's revenues, as usual, were more than sufficient to meet her expenditure. But year after year, she was called upon to meet the deficiencies of the other Presidencies and to finance most of the schemes of conquest. In 1780, Sir Eyre Coote, then Commander-in-chief, wrote to the Governor-General and his Council informing them that the treasury at Madras was empty, and that the immediate needs at Fort St. George would rather exceed seven lakhs of rupees per month, "every *cowrie* of which must come from Bengal, as he found there were no resources from which a single *pagoda* could be expected." In a letter to the India House, the Commander-in-chief lamented the necessity there was of "both the army and the inhabitants, in the state in which the country then was, being maintained chiefly by supplies from Bengal."[1]

At last, the various wars which were undertaken for the expansion of the Company's territories, and the inordinate demands of the other Presidencies, brought Bengal on the verge of a financial disaster. The belief so far indulged in that the revenues of Bengal were "an inexhaustible fund upon which the other Presidencies might

[1] *Fourth Report of the Committee of Secrecy, 1782.*

draw without limit," no longer proved true. In the concluding year of Hastings's administration, there was a deficit amounting to a million and a half pounds sterling, and for the following year, another deficit of a similar amount was estimated. Mr. Macpherson, immediately after taking charge of the administration as Acting Governor-General, wrote to the Directors: "The public distress was never so pressing as at this moment. The season of the heavy collections is over; the demands of Madras and Bombay are most pressing, and our arrears of the army are upwards of fifty lacs."[1]

Mr. Macpherson took immediate steps to meet the situation. The Court of Directors also enjoined a policy of strict economy. The total revenue of the British possessions in India in the year 1785-86 was £5,250,153. The largest share of it amounting to £4,527,283, was derived from Bengal; Madras came next with £588,524; while the share of Bombay did not exceed £134,346. In the first India Budget presented to Parliament by Henry Dundas in 1789, the revenues of the three Presidencies were stated to be: Bengal, £5,182,000, Madras, £1,082,000, Bombay, £131,000.

Lord Cornwallis followed a policy of economy, and one of the measures of retrenchment suggested

[1] *Letter dated the 4th March, 1785,* quoted in Forrest, *Selections from State Papers: Lord Cornwallis,* Vol. 1, p. 7.

by him was the almost entire abolition of the Bombay establishment. The proposal, however, was not accepted by the authorities in England. The quinquennium 1786-87 to 1791-92 witnessed a slight increase in the revenue. During this period, Bengal showed an aggregate surplus of over ten million pounds sterling. But in Madras there was an aggregate deficiency of twelve millions. Nor was Bombay far behind Madras in this respect, her total deficit during the period amounting to about ten million pounds.[1]

The mild and economical rule of Sir John Shore was reflected in the prosperous condition of India's finances. But the aggressive wars of Lord Wellesley again caused financial trouble. The peace which Cornwallis succeeded in restoring, during his second term of office, enabled his successor, Sir George Barlow, to adopt once more a policy of economy. Out of this period of seventeen years, sixteen were years of surplus in Bengal, and a deficit occurred in this Presidency in only one year. The total revenue of Bengal during the whole period exceeded the total charges, including interest, by £27,409,097.

In the Presidency of Madras, the charges always exceeded the revenues, except during the two years in which the casual payments made by Tipu

[1] *Report of the Committee appointed by the Court of Directors of the East India Company, 1793.*

Sultan, in consequence of the treaty of Seringapatam, were included. On the whole, the deficiency in Madras amounted to £11,193,883. In the Bombay Presidency, the revenues were never sufficient to defray the charges, and the total excess of expenditure during this period amounted to £18,385,745.[1]

The political accounts of the Company were separated from their commercial accounts under the provisions of the Charter Act of 1813. During the period 1814-15 to 1828-29, the aggregate revenues of the Presidencies were as follows: Bengal, £196,121,983; Madras, £82,042,967; Bombay, £30,986,970. The total charges were: Bengal, £167,747,449; Madras, £86,129,351; Bombay, £46,970,709. Throughout this period, substantial surpluses were realised in Bengal, while the normal condition of the other Presidencies and subordinate territories was one of deficit. As a matter of fact, the annual Bengal surplus during these fifteen years amounted, on an average, to £1,891,635. Madras showed an annual average deficiency of £205,758. The deficiency in the Bombay Presidency was even larger, amounting, on an average, to £1,081,595 a year. In consequence of the large surpluses realised from Bengal, there was during this period,

[1] *Report of the Select Committee on the Affairs of the East India Company, 1810.*

notwithstanding the deficits in the other two Presidencies and the enormous expenditure incurred in connexion with the various schemes of conquest, an excess of revenue over expenditure in India as a whole, amounting to £9,064,228, or an annual average of £604,281.[1]

[1] *Report of the Select Committee on Indian Affairs, 1832-33.*

CHAPTER II

CENTRALISATION AND THE WAY OUT

The Charter Act of 1833 radically changed the character of the government and introduced a system of administration centralised in respect of all matters,—executive, legislative, and financial. The superintendence, direction, and control of the whole civil and military government of the territories and revenues of India was vested in the Governor-General of India in Council.[1] It was further provided that no Governor or Governor in Council was to have the power of making or suspending any regulations or laws, except in cases of urgent necessity (the burden of proof whereof was to be on such Governor or Governor in Council), and then only until the decision of the Governor-General in Council was signified thereon. In regard to finance, it was laid down that a Governor or Governor in Council was not entitled to create any new office, or grant any salary, gratuity, or allowance,

[1] *Charter Act of 1833, Section 39.* The executive government of each of the Presidencies was, however, to be administered by a Governor and three Councillors under Section 56 of the Act.

without the previous sanction of the Governor-General in Council.[1]

These words of the Act were very comprehensive, and, if literally interpreted, they conveyed to the Governor-General in Council "the whole powers of government."[2] Whether this was the intention of Parliament, or it was contemplated that only a general control over expenditure should be maintained by the Governor-General in Council, is not quite clear. In any case, it was a matter of complaint with the provinces that the Supreme Government took advantage of the letter of the law to exercise a more minute control over the subordinate Governments than had been intended by the framers of the Act. The net effect of the changes introduced in 1833 has been described by two eminent members of the public service in India in these words: "The Local Governments, which practically carried on the whole administration of the country, were left with

[1] Section 59.

[2] These were the words used by the Court of Directors in their Despatch to the Governor-General in Council, accompanying the Government of India Act, 1833. The Directors also remarked: "The whole civil and military government of India is in your hands, and for what is good or evil in the administration of it, the honour or dishonour will redound upon you." They further observed: "It will be incumbent upon you, to draw, with much discrimination and reflection, the correct line between the functions which properly belong to a local and subordinate Government and those which belong to the general Government ruling over and superintending the whole."

almost no powers of financial control over the affairs of the respective provinces and no financial responsibility. Everything was rigorously centralised in the Supreme Government, which took upon itself the entire distribution of the funds needed for the public service throughout India. It controlled the smallest details of every branch of the expenditure; its authority was required for the employment of every person paid with public money, however small his salary; and its sanction was necessary for the grant of funds even for purely local works of improvement, for every local road, and every building, however insignificant."[1]

No sooner, however, was the change made than did its difficulties begin to manifest themselves. The policy of extreme centralisation depressed and discouraged the Provincial Governments. The ablest provincial administrators continually smarted under the excessive control of the Government of India, and their very helplessness intensified their sense of bitterness. An instance of the extreme subordination in which the Provincial Governments were held is to be found in the disciplinary action which was taken in 1836 against Mr. A. Ross, Acting Governor of the North-Western Provinces. In anticipation

[1] Strachey (Sir John and Sir Richard), *Finances and Public Works of India*, p. 134.

of the sanction of the higher authorities, he had abolished three customs stations in the interior of these provinces. Although the measures themselves were not wrong, the action taken by the Acting Governor was strongly disapproved by the Government of India, and the Secretary to that Government wrote: "These measures may be good; the Governor-General in Council is satisfied that the Hon. the Governor fully believes them to be so; they may be such as the Supreme Government would have adopted, with the whole question of customs revenue under consideration; but how is it consistent, I am desired to ask, with the supremacy and responsibility of the Government of India, that such measure should be adopted by the Subordinate Governments at their own will, without sanction or reference? When it has been fixed by the legislature that the most trifling salary cannot be created without the permission of the Supreme Government, how can it possibly have been intended that masses of revenue should be abandoned, and a whole system of customs be abolished, without reference to that superior authority?"

The Court of Directors also strongly condemned the action of Mr. Ross, and their despatch concluded with these significant words: "Such is our sense of the extreme want of judgment manifested by Mr. Ross on this occasion that, supposing he still continued to exercise

the functions of government in the Presidency of Agra, we should have come to the resolution of cancelling his appointment. In exercise of those powers we deem it necessary to direct that the administration of the Government of Agra be never again, under any circumstances, delegated to Mr. Ross."[1]

But the administration of a vast country could not be properly carried on by mere disciplinary measures. The task which the Government of India took upon itself to perform was really beyond its capacity. It did not possess the machinery with the aid of which a continuous and effective supervision could be maintained over provincial affairs. But the more serious defect of the centralised system was that it led to extravagance. The Provincial Governments were not responsible for raising their revenues or for regulating expenditure within their income. The resources of the whole country were under the exclusive control of the Government of India, by which grants were made to the provinces on detailed estimates of the needs of the different departments. Each Provincial Government tried to get as much money as possible by maintaining the absolute necessity and urgency of its estimates.[2]

[1] *Despatch from the Court of Directors to the Government of India, dated the 1st February, 1837.*

[2] *Vide* W. N. Massey's evidence before the Select Committee, 1872, and Chesney, *Indian Polity*.

The Government of India did not possess the local knowledge which could enable it to scrutinise efficiently those demands. But it had to decide. Thus allotments were made by a sort of compromise under which the rival claims were adjusted, not so much by their intrinsic weight, as by the importunity of the applicants. Nor did the system offer any inducement to the Provincial Governments to observe economy, for they knew that savings under one head would not be applied to improvements in another but would return to the source from which money had originally, perhaps with much difficulty, been obtained.

The difficulties grew with the lapse of time, and the defects of the system were reflected on the financial position of the country. During the period 1834-35 to 1857-58, deficits occurred in no less than seventeen years, while only seven were years of surplus. These deficits were met by a recourse to loans. On the 30th April, 1834, the public debt of India amounted to £41,350,952; but on the 30th April, 1857, that is to say, on the eve of the Mutiny, it had increased to £59,441,052. This increase, it should be noted, took place in spite of a sum of nearly ten millions sterling having been applied out of the commercial assets of the Company to the reduction of debt. The main cause of these deficits, it is true, was war; but financial mismanagement also contributed to the result in no small degree.

Another defect of the financial system was that the accounts were not kept in a proper form. There were various anomalies, the least defensible among them being that the accounts of the Central Government were mixed up with those of the Bengal Presidency.[1] The result was that, although the position of Bengal was, throughout this period, one of excess of revenue over expenditure, recurring deficits were shown against the province. There was a substantial surplus in each of these years in the North-Western Provinces. Madras experienced more years of surplus than of deficit, while the Bombay Presidency had the unenviable distinction of being a deficiency province during nearly the whole period. The revenue of the Punjab was, on an average, just enough to balance its expenditure during the few years which elapsed between the conquest of the province and the Sepoy Mutiny.

The situation in India became extremely acute when the Mutiny not only entailed a severe repression of expenditure, but necessitated the levy of a large amount of additional taxation. The Government of Madras presented a definitely hostile attitude towards the taxation proposals put forward by Mr. James Wilson.[2] Sir Charles

[1] The accounts of Bengal were separated from those of the Government of India in 1846.

[2] "According to our belief," wrote the Government of Madras, "this is a more serious crisis than the Mutiny itself."—*Despatch from the Governor and Council of the Madras Presidency to the President and Council of India, dated the 26th March, 1860.*

Trevelyan, a man of long and varied experience and an administrator of conspicuous ability, who was then the Governor of the Presidency, held the view that the financial difficulties of the Government of India could be overcome by retrenchment, and he considered the imposition of new taxes not only undesirable, but fraught with danger. "It is characteristic," he wrote, "of the manner in which these tremendous taxes are proposed to be applied to all the various peoples, nations and languages, composing the British Empire in India, that there are confessed to be 'absolutely no data upon which any reliable calculation can be made of their result.'"[1]

The Government of India took their stand on their own constitutional position and strongly disapproved of this attitude on the part of the Madras Government. They observed: "Who is to be responsible for the solvency of the Empire? Is it to be open to any Local Government who has only its own accounts before it, and who is in no way responsible for home charges, or for the expenses of the Government of India, for interest on the public debt, or railway moneys, to say to the Government, 'We do not credit your accounts, we doubt your judgment on the stability of your present sources of revenue, we disapprove your scheme of taxation, and we mean to oppose

[1] *Minute by Sir Charles Trevelyan, dated the 20th March, 1860.*

it to the utmost of our power...' This is virtually what the Government of Madras now says, and it is clear that if it can maintain the position it has taken up, the functions of the Government of India have ceased.''[1] The Secretary of State for India also took strong exception to the observations of Sir Charles Trevelyan, particularly to his action in publishing the correspondence on the subject. Matters, indeed, went so far that Sir Charles Trevelyan was recalled from the Governorship of Madras.

In the meantime, it had come to be generally recognised that centralisation had been carried too far. When, after the Mutiny, the question of the transference of the administration of India to the Crown was under the consideration of Parliament, Mr. John Bright, impressed with the vastness of the country and the linguistic and other differences which characterised its different parts, proposed that the central government under the Governor-General in Council be abolished and that India be divided into a number of autonomous governments, each of them directly subordinate to the Secretary of State in England. This proposal was, indeed, of too sweeping a character to be acceptable to any one acquainted with the needs of the country. But few could deny that there

[1] *Letter from the Government of India to the Government of Madras, 1860.*

was a basis of truth and wisdom in his suggestion that decentralisation was an essential condition of progress in India. "What you want," said Mr. Bright, "is to decentralise your government... You will not make a single step towards the improvement of India unless you change your whole system of government—unless you give to each Presidency a government with more independent powers than are now possessed."

In 1858, the direct administration of India was taken over by the Crown. Under the provisions of the Government of India Act, the Secretary of State in Council occupied the position which had been previously occupied by the East India Company and the Board of Control. But although the final responsibility for the control of the finances of India was vested in the Secretary of State and the Council of India, it was found necessary in practice to delegate an ample measure of financial discretion to the Governor-General in Council. No alteration was, however, made in the centralised system of administration within the borders of India itself. But the feeling continued to grow that some degree of local initiative and control must be transferred to the Provincial Governments.

In 1859, the Secretary of State for India declared that Her Majesty's ministers were endeavouring to afford some relief to the central authority at Calcutta. With regard to finance, he made the following significant observation: "An important

question arose as to the destination of local taxes. If each province had a surplus, nothing could be more reasonable than that what remains after contributing its quota to the Imperial expenditure, should be spent by the local authorities on their own local objects."

It was not, however, provincial surpluses but Imperial deficits that actually prompted the suggestion of a policy of financial decentralisation. Mr. James Wilson, the first Finance Member of India, touched on the question in the course of his budget speech in February, 1860.[1] A few months later, Lt.-Gen. Dickens, then Secretary to the Government of India in the public works department, wrote a memorandum in which he condemned the then existing financial system, under which there was a constant conflict between the Government of India and the Provincial Governments. He suggested a reform in the direction of provincialising the finances of the country. It was, however, left to Mr. Wilson's successor in the office of Finance Member, Mr. Samuel Laing, to make a definite attempt to introduce a provincial system of finance. In accordance with his advice, a confidential circular was addressed on the 16th March, 1861, to all

[1] Mr. Wilson's Income-tax Bill contained the provision of a tax of 1 per cent. on incomes above Rs. 500 (in addition to the 3 per cent. tax for the general treasury) to be appropriated to local purposes.

Provincial Governments in which it was pointed out that the financial condition of the Government of India rendered it necessary to reduce the grant for public works. But it was felt that any curtailment of these works was undesirable. The Governor-General in Council, therefore, proposed to make over to the Provincial Governments certain subjects for provincial taxation, by means of which they might, each in its own way, raise local revenues wherewith to supplement any deficiency of imperial assignments for public works. Tobacco was suggested as a fit subject for provincial taxation, and the Government of India agreed to consider any other subjects which might be proposed by the provinces. The Provincial Governments were given to understand that it was not necessary that these taxes should be uniform even throughout the same province. Arrangements were also to be made to give the Provincial Governments credit for any savings which were effected by them in their own expenditure.

The Government of Bengal accepted the offer, and expressed its willingness to contribute a sum of 15 lakhs of rupees. But Mr. (afterwards Sir John) Peter Grant, the Lieutenant-Governor, observed that it was "a practice handed down from the beginning of the British Empire in India to make Bengal pay much more than its share of the Imperial revenue, and to give it back in return not a quarter of its share of the imperial funds granted

for such objects as military protection, police, roads, and other public works." He saw "this inevitable practice still in operation," and took this opportunity to attract notice to "systematic inequalities so injurious to the provinces" with which he was connected.[1] The Government of Bengal urged that the license-tax be provincialised, and that the increase of the net *abkari* revenue be made over to the Provincial Governments. It also proposed to raise a tobacco tax and a betel-leaf tax by means of licenses. The Government of India accepted these latter proposals, but refused to make the license-tax a provincial source of revenue or to make over the increase of *abkari* revenue to the provinces. On the question of the unfair treatment meted out to Bengal, the Government of India wrote: "His Excellency in Council observes that it is undoubtedly true that Bengal has not received its due share of imperial expenditure, if this share is measured by the considerations noticed by His Honour. On the other hand, the people of Bengal are certainly not the most heavily taxed in India; and in estimating the claim of each province of one Empire to be supplied with funds for local works, it is, His Excellency in Council observes, necessary to consider in what parts of the Empire such works, whether roads, works of irrigation, or others are most

[1] *Letter from the Government of Bengal, dated the 4th May, 1861.*

wanted."[1] In this connexion, Mr. Forbes, member of the Legislative Council of India representing the Government of Madras, observed: "When Mr. Grant complains that Lower Bengal does not receive its fair share of public works expenditure, I think he leaves too much out of consideration that the permanent settlement has deprived the Government of the inducement to expend money in these provinces: they would receive no direct return for their outlay; and although the indirect return would be inducement enough, if they could do no better, it is not surprising that they prefer to expend capital in those parts of the Empire where the return is both direct and indirect."[2]

The Lieutenant-Governor of Bengal prepared a memorandum in which, *inter alia*, he replied to the observations of the Governor-General in Council and of Mr. Forbes. He wrote: "I hope it is not intended to maintain a principle of allotment between the several Governments of the portion of the general imperial revenues appropriated to imperial public works, which really is tantamount to unduly taxing the most important part of the empire for the undue advantage of less important parts, by reference to the permanent settlement. Whatever discussions may be raised

[1] *Letter from the Government of India to the Government of Bengal, dated the 17th May, 1861.*

[2] *Letter from the Government of India to the Government of Bengal, dated the 3rd August, 1861.*

concerning that settlement in other respects, its wonderful financial success is beyond all question. The settlement, as a whole, was a very heavy assessment at the time. Let the percentage of increase, which the gross revenue of Bengal from all sources now as compared with that in 1790 shows, be compared with the corresponding percentage in Madras before saying that Bengal works are not to be allowed their share of Bengal revenue, because Government cannot increase the Bengal land-tax."[1]

Some of the other Governments agreed to raise small sums by means of provincial taxes. But the Government of Burma refused to levy any additional taxation. The Government of Madras regretted that it could not undertake to raise any additional revenue from tobacco, and was unable to suggest any other subject of taxation. The Governor of the Presidency, Sir William Denison, observed in this connexion that provincial taxes for public works on a population already too heavily taxed would justly expose the Government to obloquy. He also thought that the transfer to Provincial Governments of savings in the estimated expenditure of each year would offer a direct inducement to the framing of high estimates of departmental outlay. Sir William, however, admitted that there was much in a decentralisation

[1] *Memorandum by Mr. J. P. Grant, dated the 10th August, 1861.*

of finance to make the scheme attractive. "I should rejoice," he wrote, "I confess, to see some power of local action given over to those who are interested in public works of a local character; but I am, at the same time, bound to admit that the slight experience which I have had of the character of the people does not lead me to believe that they would appreciate the boon, if coupled with the condition of a local rate or cess." Mr. Maltby, a member of the Executive Council of Madras, thought that the limited amount of local financial management and self-government proposed by Mr. Laing would be quite insufficient and barren of good results. "If they (the Provincial Governments) are to enjoy real liberty of action and self-management," observed Mr. Maltby, "it seems to me that the Acts of Parliament affecting India must be altered so as to give them a control over the general taxation and expenditure within their range, subject to the condition of supplying a fixed contribution to the Imperial Treasury; and I would, with all deference, point to the present papers as a proof how impossible it is that one Central Government, overwhelmed with political and other great questions, should successfully master the details of local administration throughout our extensive Empire."[1]

[1] *Letter from the Government of Madras to the Government of India, dated the 22nd April, 1861.*

Mr. Laing gave an exposition of his scheme on the occasion of the presentation of the annual budget in the Legislative Council in April of that year. He said that he proposed to cut down the provision for public works by half a million and hand over the department to the Provincial Governments. The Finance Member defended this proposal by asserting that public works, including irrigation and communications, were a subject which could be dealt with better by the provinces than by the Central Government. He also expressed the view that certain taxes might well be raised locally. It was his desire, he said further, to place no limit upon the powers of the Provincial Governments in this matter except this that every proposal for local taxation should be subject to the sanction of the Governor-General in Council, and of the Legislative Council when a law was required, in order to see that it was not inconsistent with imperial taxation or with imperial policy. In his opinion, this was the only means by which the imperial budget could obtain the requisite relief, while more money could be spent on useful local works. But the Finance Member had in view an object even higher than this. "By enacting local budgets," said Mr. Laing, "the Government hope not merely to meet a temporary difficulty, but to inaugurate a permanent improvement. It has been a standing complaint with the other Presidencies and Provinces, that they were

deprived of their fair share of self-government, and kept in a state of galling and humiliating dependence upon the *bureaux* of Calcutta. Well, Sir, the power of the purse is the ultimate power, and as long as Local Governments are absolutely subservient to Calcutta in financial matters, it is evident that they can have no real independence. But if, without sacrificing the unity of the Empire and imperial control in imperial matters, we give them local budgets, their position is altered. We propose to give them not only powers of local taxation, but possibly to credit them with a liberal share of reductions of expenditure, which they may be able to make on the estimates of the general budget. Each Government will thus have a direct interest in economy, in order to increase the fund applicable to local works."[1] This scheme would also, Mr. Laing hoped, greatly foster the spirit of local self-help and self-guidance. India, he added, was not altogether devoid of that spirit of self-government which characterised the Anglo-Saxon, for in her village communities and *panchayats*, could still be found traces which would remind them that the Hindu, as well as the Englishman, was "descended

[1] *Financial Statement, 1861-62.*

In the course of his evidence before the Select Committee on Indian Finance, 1872, Mr. Samuel Laing claimed that he had originated the idea of transferring a part of the expenditure as well as a part of the receipts to Local Governments, so that they might have local budgets for local purposes.—*Vide Minutes of Evidence, 1872.*

from a common stock of Aryan ancestors." Mr. Laing concluded his observations with a glimpse of the vision he had of the future of India when her people would gradually be trained by the management of their own local affairs for those of a wider area, so that India might "at length have a political life and become a nation."[1]

The Finance Member's intention of transferring £500,000 to provincial budgets to be provided for by local taxation was not actually carried out. The reason was that, as under the Indian Councils Act of 1861 legislative councils were to be established in the three Presidencies, it was not thought proper to anticipate the action of these bodies in a matter which was peculiarly their province. In the following year, Mr. Laing reiterated his view that it was most desirable to break through the system of barren uniformity and pedantic centralization which had tended in the past to reduce all India to dependence on the *bureaux* of Calcutta, and to give to Provincial Governments the power and the responsibility of managing their own local affairs. "I am as strongly as ever," he said, "in favour of the principle of local taxation for local objects. In fact, if this great Empire is ever to have the roads, the schools, the local police, and other instruments of civilisation, which a flourishing country ought to possess, it is simply

[1] *Financial Statement, 1861-62.*

impossible that the Imperial Government can find either the money or the management. The mere repair of the roads, where anything like a sufficiency of good roads has been made, is a matter altogether beyond the reach of any central *bureau*."[1] Mr. Laing's plan was that the main heads of expenditure, such as the army and the national debt, as well as the chief sources of revenue, should continue to be imperial; but the remainder of the field, both of revenue and expenditure, might properly be regarded as provincial. He also expressed the view that, if the income-tax was to be permanent, he would much rather see it transferred into a provincial tax than continued as an imperial resource.[2]

The primary object of Mr. Laing's proposal was thus the relief of imperial finance. But the subsidiary objects were also important. These were: first, to provide for the execution of useful works otherwise than from the existing imperial revenues; secondly, to give the Provincial Governments a motive for economy in all expenditure under their control; and thirdly, to foster the spirit of local self-help. The year 1862-63 proved to be one of financial prosperity; and as the primary motive disappeared, the scheme was dropped for the moment.[3]

[1] *Financial Statement, 1862-63.* [2] *Ibid.*

[3] *Vide* J. F. Finlay's *Memorandum on Provincial Financial Arrangements.*

It was, however, not long before the Government again found itself faced with a deficit. The question of provincial decentralisation was, therefore, revived in 1866. In February of that year, the Finance Member, Mr. W. N. Massey, addressed a demi-official circular to all Provincial Governments pointing out the necessity of making provision for a permanent addition of at least a million sterling to the existing revenues. In this letter he formulated a scheme by which Provincial Governments would be required to take over £1,200,000 sterling[1] of imperial charges, and then to proceed to raise that amount of revenue. The scheme of 1861 for local taxation was laid aside. The heads of imperial charge suggested to be transferred were education, police, jails, and public works, while the proposed sources of provincial taxation were license-tax, house tax, octroi, and a succession duty.

This scheme did not find much favour with the Provincial Governments. The Government of Bombay pointed out that Mr. Massey's scheme had little in common with the previous projects of Mr. James Wilson and Mr. Laing, inasmuch as the earlier Finance Members had contemplated new local taxation for local expenditure, Mr.

[1] This figure was arrived at by an assessment of 4 per cent. on the estimated revenues of the several Provincial Governments (except Burma), for the year 1865-66, after excluding customs duties and income-tax.

Massey proposed it in relief of existing imperial expenditure. The Governor of Bombay, Sir Bartle Frere, observed that a mere transfer of imperial charge to local funds raised for other objects was objectionable. He urged, therefore, that, if imperial charge be made over, taxes sufficient for meeting the charge should also be transferred to local funds. He suggested the re-imposition of an income-tax, the proceeds of which were to be made over to Provincial Governments.[1] The Madras Government considered that it would be wise on the part of the Government of India to face the difficulty boldly, and devise some scheme by which the annual increase of charge might be met by an equivalent increase of revenue, rather than have recourse to expedients like those suggested in Mr. Massey's letter. The Lieutenant-Governor of Bengal, Mr. Cecil Beadon, urged that his province should not be required to contribute 30 lakhs of rupees as proposed. "Bengal," he added, "already contributes far more to the general finances of the country, and receives far less in proportion to area, revenue, or population than any other province."[2] He further observed that the time had arrived to resort much more largely than hitherto to provincial taxation, not for

[1] *Minute by the Governor of Bombay, dated the 25th November, 1866.*

[2] *Letter from the Lieutenant-Governor of Bengal, dated the 8th March, 1866.*

the relief of imperial finances, but for the improvement of the country. He objected to some of the sources of taxation proposed by the Finance Member, and suggested other methods of raising revenue. The Government of the North-Western Provinces was not favourable to the proposed transfer of imperial charges to the provincial account, unless provincial liability was clearly established. It considered additional taxation inexpedient, and expressed its strong disapproval of direct taxation in any form. If reduction of expenditure was not possible, it urged that public works to the extent of the deficit should be either postponed or carried out by means of loans.[1] The Punjab Government thought that the sum of 11½ lakhs required of it might be raised without any serious difficulty, if the mode of levy was left to local determination. The Chief Commissioner of the Central Provinces suggested that its quota

[1] The Lieutenant-Governor of the North-Western Provinces suggested a different distribution of the levy, namely,—Bengal, 35¼ per cent. of the total contribution; Bombay, 23½; Madras, 15½; North-Western Provinces, 14½; Punjab, 5¼; Oudh, 3½; Central Provinces, 2½. He urged the following arguments in favour of this proposal. "There is also a manifest propriety in these rates, inasmuch as the larger proportion of the additional burden is thrown upon Bengal and Bombay, the first of which is more lightly taxed, as regards land revenue, than other provinces, while the latter, by its recent extraordinary commercial development and the attendant depreciation in the value of money, of itself a cause of the demand for additional revenue." *Vide Letter from the Lieutenant-Governor of the N.-W. Provinces to the Financial Member of Council, dated the 8th March, 1866.*

of $3\frac{1}{2}$ lakhs might be raised by extending the license duty, and by levying a house tax, an octroi, and a succession duty.

In January of the following year, Mr. Massey submitted a modified scheme for the transfer to the Provincial Governments of a few heads of expenditure, exclusively of a local character, amounting in the aggregate to £8,000,000, accompanied by a license-tax. This was assented to, as an experimental measure, by the Governor-General in Council, but was postponed on account of the state of the finances. The license-tax was appropriated, for the moment, to the exigencies of the Government of India.

In the course of the year, Mr. Massey put forward his second scheme, the details of which were worked out by Colonel (afterwards Lt.-Gen. Sir) Richard Strachey. In a Note written on the 17th August, 1867, Col. Strachey pointed out that an extraordinary change had taken place in the magnitude of the interests with which the Government of India had to deal in the course of the previous ten or fifteen years. With revenues and expenditure more than doubled, the business of control of the public finances had increased more than four-fold, while the enormous growth of commerce and the great impetus given to material and social progress had put a great strain on all branches of the administration. Under a pressure of this description, Col. Strachey

thought, the old rigorously centralised system of finance in India had shown the most unmistakable signs of its incompatibility with the altered state of things.[1] "I have the strongest conviction," he wrote, "based on my experience gained in the Public Works Department, and fortified by all that I have seen and heard for the last ten years, that the existing financial relations between the Government of India and the Local Governments are most demoralising to the latter. These having the least possible interest in the public revenues, strive to obtain the largest possible share of them to meet their expenditure. They have found by experience that the Government of India can hardly resist clamour, if it is loud enough and persistent enough. The distribution of the public income degenerates into something like a scramble, in which the most violent has the advantage with very little attention to reason. As local economy leads to no local advantage, the stimulus to avoid waste is reduced to a minimum. So, as no local growth of the income leads to an increase of the local means of improvement, the interest in developing the public revenues is also brought down to the lowest level. The Government of India has altogether

[1] Col. Strachey also expressed the view that at the bottom of the disagreements which had occurred between the Government of India and that of Bombay lay the unhealthy financial system which both Governments found handed down to them from the past.

lost what power it once had of supervising details, by reason of the enormous magnitude of the business now to be performed by it; and the financial mechanism is, as it seems to me, seriously out of gear."

The scheme prepared by Col. Strachey, at Mr. Massey's instance, was one of federal finance. Under it the financial position of the central authority in India was by degrees to be brought to assimilate generally to that of the Federal Government of the United States. The essence of the proposal was to transfer, not only expenditure, but also revenue. The heads of expenditure to be transferred were: law and justice, police, education, medical services, stationery and printing, and some miscellaneous items. The revenues to be made over to the provinces were: $\frac{1}{16}$th of the land revenue,[1] $\frac{1}{4}$th of the income-tax (to be levied at 2 per cent. with a taxable minimum of

[1] With regard to land revenue, Col. Strachey wrote: "The transfer of this portion of the land revenue is justified, I consider, by the consideration that the land revenue is perhaps the best general standard by which to measure many of the claims for public outlay. Particularly, I think, this holds good as regards the provision of roads, the whole of the charges for which it will be seen hereafter that I propose to transfer to local management. It is mainly to the agricultural interests that good roads are of importance. India being, essentially, an agricultural country, and its wealth depending so greatly on the possibility of its produce being exported with profit, the construction of roads is of the first necessity for general prosperity."

Rs. 2,000), and ¼th of the license-tax.[1] The Provincial Governments were also to be permitted to add to any of the then existing revenues by a cess on such revenue, or by the introduction of new forms of taxation. The charges of collection on the transferred revenues were to be borne by the Provincial Governments, in the proportion of transfer. The receipts of the departments transferred to the provinces would also be provincial. Such transfers were to be final. No claims for additional funds to meet increased expenditure under transferred heads were to be attended to by the Central Government, but all such increases were to be met from the expansion of the revenue transferred or from additional provincial taxes. The charges proposed for transfer were estimated at £1,569,900 ; while the corresponding transfers of revenue were estimated at £2,765,300, which, after providing for the civil charges, would leave a residue of £1,195,400, applicable to public works. The transferred revenues and

[1] Col. Strachey suggested the assignment of definite shares of these taxes in order to give to the provincial authorities a direct interest in working taxation of this sort in the most profitable manner. He observed: "It appears to me that this principle of sharing the revenues between the central and local authorities is one which will generally be found useful in practice, not only on such grounds of economy as have just been noticed, but also as giving a means of creating distinct local revenues without the introduction of new forms of taxation and without the action of separate tax-gathering establishments, both of which necessities must arise under any other system, and both of which are, if possible, to be avoided."

charges were to be exclusively administered by the Provincial Governments. The provincial budget would exhibit the whole of the estimated public income and outlay in each province. The Government of India would reserve its right of withdrawing from the Provincial Governments any needful revenues in case of emergency. A financial department was to be organised under each Provincial Government.

On the 7th September, 1867, Mr. Massey wrote a Minute briefly describing his second scheme and emphasising his view that the best mode of restraining public expenditure relating to the provincial services was to assign to the Provincial Governments the administration of, and responsibility for, them. He pointed out that the proposed transfers on each side would amount to about £2,700,000, and would constitute the first step towards a complete separation of imperial from provincial finance. The principle of his scheme was that a final adjustment should be made of the claims of the Provincial Governments upon the Central Government in respect of the heads of charge transferred. Any increase of such charge which local circumstances might require was to be met either by retrenchment under some other head, or from increment of assigned revenue, or from provincial taxation. New heads of charge for provincial purposes were, as a rule, to be provided for in

like manner, special applications being reserved for the consideration of the Governor-General in Council.[1]

Sir John (afterwards Lord) Lawrence, then Governor-General, was somewhat doubtful of the arrangement, but he did not oppose it at the very start. He thought that, after circulation, the question should be considered in Council. This procedure was adopted. Major-General Sir H. M. Durand could not assent to a great deal in Col. Strachey's Memorandum. He was opposed to the weakening of the control of the Government of India, and suggested the assembly of a congress of the ablest officers from the different provinces to discuss the whole matter. Mr. (afterwards Sir Henry) Maine, the Law Member, entirely agreed with the proposal, but doubted whether it went far enough.[2] Sir W. R. Mans-

[1] Col. Strachey made the further suggestion that the Provincial Governments should be enjoined to give to the localities where the income-tax and license-tax were raised, a specific portion of the assigned shares of those taxes. *Vide Note by Col. Strachey, dated the 17th August, 1867.*

[2] *Minute dated the 10th September, 1867.* A few days later, Mr. Maine, on the eve of his departure from India, wrote another Minute in which he remarked that Mr. Massey's proposal was "as remarkable for its moderation, as for any other characteristic." He observed further that, if the Provincial Governments were extravagant, it was the system which made them so; nor was it any wonder that a Provincial Government should try to get all that was to be got, and should not be very scrupulous in its contrivances for getting it. He added: "I see positive advantage in curtailing, to some extent, the proportion of the revenues of India at the absolute disposal of the Central Govern-

field, the Commander-in-Chief, trusted that the measures might be pushed forward to completion after due investigation of details. Mr. G. N. Taylor expressed himself in favour of introducing the principles of the scheme. Sir G. N. Yule, after pointing out the evils of the existing system, concurred in the views of Mr. Massey.

On the 19th September, 1867, a circular was sent to all the Provincial Governments explaining the enlarged scope of Mr. Massey's revised proposals and inviting expressions of opinion on the details of the scheme. The scheme was also reported to the Secretary of State. On the 27th September, 1867, the Governor-General wrote a Minute discussing its principles as well as its details. He considered it inexpedient to enlarge provincial responsibility to an indefinite extent. He agreed that, to a certain extent, the responsibility for managing provincial revenues and expenditure should devolve on the Provincial Governments. But he feared that entire responsibility would eventuate in an absence of all responsibility

ment, and in finally appropriating a considerable part of those revenues to the needs of Local Governments. I can quite conceive a campaign on the Oxus or the Jaxartes being undertaken with less precipitation, if the Supreme Government had lost the power of summarily stopping all public works throughout India, and could only pay for military glory by borrowing or taxation. If the Indian public debt be analysed, I venture to say that, putting aside the results of the events of 1857, it will be found to have been mainly incurred through imperial, and not through local, extravagance."—*Minute dated the 13th September, 1867.*

in practice, and would lead to extravagance and waste. Sir John Lawrence denied that there had been any collision between the controlling power and the subordinate Governments of India, and observed that provincial responsibility and central supervision existed in tolerably fair proportions at the moment. Complete provincial responsibility and supervising authority of a useful character could not, he thought, co-exist. Another difficulty likely to arise from the proposed change would be a confusion of accounts. The Governor-General urged many other objections against the scheme, and expressed the opinion that the system of the United States was not applicable to India.

The Financial Secretary, Mr. E. H. Lushington, submitted an elaborate Note in which he expressed the opinion that the observations on the two propositions in Col. Strachey's Memorandum were not necessarily connected. The minor proposition for enlarging the powers of the Provincial Governments did not seem to him objectionable; but he took serious exception to the proposal for surrendering to them large heads of expenditure with a corresponding amount of revenue. He challenged the allegation that the financial control of the Government of India was weak, and expressed his conviction that under Mr. Massey's scheme Provincial Governments, in order to find additional funds, would not improve existing

revenues, but would simply increase the cesses.[1] Major-General Sir H. M. Durand concurred in most of the observations contained in Sir John Lawrence's Minute, and expressed his emphatic opinion that a radical change of the existing financial system was unnecessary, inexpedient, and pernicious.

Mr. Massey wrote another Minute to criticise in detail the objections urged by the Governor-General to his scheme. He controverted the view held by the Viceroy that the public revenues were reasonably well administered under the then existing system, and observed that, if it could be shown that the existing system worked well, or that the proposed change would not work better, he would be content to abandon the scheme. Nor did he share the Governor-General's apprehension that a confusion in the accounts would arise from a transfer of certain portions of the public revenue to provincial control. He pointed out that the relative positions of the Government of India and of a Provincial Government were antagonistic in respect of financial administration; for the tendency of the former was to guard the imperial revenue from undue demands, while the disposition of the latter was to increase its own expenditure. The object of the plan under discussion was to fix a limit to the strain put upon the

[1] *Note by Mr. Lushington, dated the 28th September, 1867.*

imperial finances by provincial expenditure. Lastly, he expressed his conviction that a centralised system of finance, which was appropriate to a compact territory, homogeneous in its character, was unsuited to a vast disjointed empire, comprising provinces and races widely different in many important conditions and circumstances.[1]

Sir W. R. Mansfield gave his firm support to the scheme of federal finance. After pointing out the defects of the existing system, he observed: "According to the view now suggested for consideration, it is wished to make the Local Governments partners in the great joint-stock of the Indian Finances, and so, to enlist their interest and animated co-operation with the Government of India, instead of keeping them on the footing of agents and servants, who, having no motive for economy in using the means of their master, think only of enhancing their own demands by comparisons, more or less well founded, with the indulgence conceded to others. Thus Mr. Massey would apply to the minor Governments a financial policy which is found to be universally effective in the affairs of commerce, *viz.*, to engage, on his side, for imperial purposes the influence of self-interest, in the place of salaried indifference on the part of those who spend a large portion of the revenue, but have none of the

[1] *Minute dated the 10th October, 1867.*

responsibility for the general provision of the ways and means." [1] The other members of the Governor-General's Council, with one exception, also whole-heartedly agreed with Mr. Massey.[2]

Sir John Lawrence thought fit to revert to the question before long. In a Minute written on the 22nd October, he said that the existing system had been inaugurated by Mr. Wilson on the principle that economical administration of the finances, rather than increased taxation, was expedient, and that this principle had been recognised by Mr. Laing and Sir Charles Trevelyan. He pointed out that British authority in India had been maintained by a handful of foreigners, and expressed the fear that any relaxation of the control of the Central Government was likely to lead to evil results. He thought that the serious growth of the public debt since 1840 and the decision to borrow for extraordinary public works were strong reasons for strengthening, instead of weakening, the control of the Government of India. Sir Henry Mortimer Durand concurred in the observation of the Governor-General that it was not

[1] *Minute dated the 17th October, 1867.*

Sir W. R. Mansfield pointed to his experience as a member of the Bombay Council where there was a never-ceasing jar with the Government of India.

[2] Mr. G. N. Taylor hailed the proposition as a first step in the direction of a more liberal concession to the Provincial Governments, and believed that it would create a strong motive for economy in provincial administration.

relaxation of financial control that was necessary, but the reverse. The adoption of this scheme would tend, in his opinion, to strike a blow at the confidence which British capitalists were entertaining in Indian investments, and deprecated any step which might discourage the flow of English capital to India.[1]

The Provincial Governments, with one exception, cordially approved of the main principles underlying the scheme, but some of them suggested modifications in regard to its details.[2] The Board of Revenue in Madras expressed the opinion that the scheme, if carried out in a spirit of fairness, could not fail to be eminently conducive to efficient and successful administration.[3] It

[1] *Minute dated the 2nd November, 1867.*

[2] The Lieutenant-Governor of the North-Western Provinces was fully satisfied with the sound and liberal views embodied in the scheme. The Chief Commissioner of Oudh, Mr. J. Strachey, considered the scheme to be thoroughly sound. The Lieutenant-Governor of the Punjab cordially approved of the scheme. The Chief Commissioner of British Burma heartily approved of the proposals, but considered the small amount of assignment proposed for his province to be unfair. The Chief Commissioner of the Central Provinces expressed the view that the Government of India should retain the expenditure under the army, interest on public debt, pensions, and railways, with customs, salt, opium, and mint receipts and a portion of land revenue, and should make over the remaining items of expenditure and revenue to the Provincial Governments.

[3] The Board of Revenue said that it had always been the complaint of the Government of Madras that it had not received a share of the general revenues commensurate with its just claims. It also made various other suggestions.—*Letter from the Board of Revenue to the Government of Madras, dated the 27th January, 1868.*

urged the acceptance of the principles on which the scheme was based, but thought that the revenue to be transferred was comparatively insignificant. The Board regretted that the Government of India had not adopted the plan of making everything over to Provincial Governments except imperial charges, towards which each Provincial Government should contribute a fair share. The Governor of the Presidency, Lord Napier of Merchistoun, however, opposed the measure. After analysing the respective advantages of an imperial and a federal system, he came to the conclusion that centralised finance, with a centralised authority, was most advantageous to India at large, and to the consolidation of the British power, but that the federal system was likely to be most beneficial to the old provinces, specially to Madras. He added, however, that, if financial and administrative independence was offered immediately to Madras, in connexion with a federal constitution, the Government of the Presidency would act with superior wisdom in declining it. Lord Napier thought that municipal taxation and the road-cess were destined to work out the most important ameliorations in the country, and to these sources of local revenue he suggested the addition of two more, namely, the levy of a tax on trades and professions and an additional 5 per cent. on the assessment of wet lands. He advised the members of his Council to send a

reply to the effect that the Madras Government regarded Mr. Massey's proposal as of too partial and inconclusive a character to justify a disturbance of the existing system of financial administration.[1] Mr. H. D. Phillips, a member of the Council, concurred in this opinion.

Mr. A. J. Arbuthnot, another member of the Executive Council of Madras, concurred generally in the objections advanced by the Governor against the proposed changes in the system of financial control. If it were thought desirable to introduce any changes of a limited extent, he felt inclined to prefer the scheme submitted by the Board of

[1] The main advantages of the centralised system, according to Lord Napier, were as follows: (1) The system had existed for a long time; its inconveniences were known, were diminishing, and might be entirely redressed by enquiry, by regulation, and by moderation and discretion on the part of those in power. (2) Under the imperial system, there was a splendid and powerful Central Government, which, under the federal system, would become a pensioner of the Provincial Governments. (3) India's credit in the English money market was equal to that of France or the United States, and superior to that of Russia; with a disintegrated revenue that high position could not be maintained, and the confidence of Indian capitalists would also be shaken. (4) The Supreme Government with its centralised revenue fitly represented the majesty of the British sovereign, and commanded the resources for meeting any emergency in any part of the Empire, and for incurring expenditure necessary for the general welfare, which the tract more immediately affected could not bear from its local resources. Lord Napier, therefore, demurred to the policy of those who would restrict the benefits of the Supreme Government to its receipts, and who would measure out, in a parochial spirit, to every province, appropriations proportioned to its specific returns. He also thought that the manner in which proposals for "a financial and political revolution" had been put forward was not quite regular and right.—*Minute dated the 15th February, 1868.*

Revenue. But he questioned the policy of any such partial localisation of revenues and charges, for they would, in his opinion, tend rather to delay than to facilitate, the introduction of a more complete decentralisation, and would not very materially diminish the amount of supervision which was at the time exercised by the Supreme Government over the Provincial Governments. Mr. Arbuthnot thought that freedom of action, within certain financial limits, would supply incentives to economy. He then suggested a scheme under which certain branches of expenditure would be set apart as imperial, and the quota to be furnished by each Provincial Government towards imperial expenditure should be determined annually by the Governor-General in Council, while the remainder of the revenues of the province would be left at the disposal of the Provincial Government. With a view to establishing a thoroughly effective check over the expenditure of the Provincial Governments, he suggested the following procedure: "Each Local Government should be required to submit annually to the Local Legislative Council a budget estimate exhibiting the probable amount of revenue which, under the orders of the Government of India, will be left at its disposal, and the expenditure which it is proposed to incur. The votes of the Council should be taken on the budget, section by section, or item by item, it being open to any member to move the

omission or reduction of any particular item of expenditure which he might deem unnecessary or unduly high, or an increase of charge when he might regard the budget provision too low, or the insertion of any new charges which he might deem called for. On all such amendments the votes of the Council should be taken, and the budget should be finally passed and embodied in an Appropriation Act, as voted by the majority of the Council."[1] It is most unfortunate that these proposals did not commend themselves[2] to the persons controlling the political destiny of India until half a century later, and even then they were not carried into full effect.

On the 23rd March, 1868, the Governor-General wrote another Minute, in the concluding portion of which he observed: "I believe that there is as strong a necessity as there ever was, as strong a necessity as there could possibly be, for one central absolute authority in India, to which

[1] Mr. Arbuthnot suggested that the votes should be subject to the following restrictions, namely, that it should not be in the power of the Council to vote the creation of any permanent charge exceeding a certain amount, say Rs. 1,000 per month, or to raise any existing charge of a permanent character above that amount, or to vote the abolition or reduction of any permanent charge exceeding that amount, unless the permission of the Governor-General in Council had been previously obtained.—*Minute dated the 25th February, 1868.*

[2] It is worthy of note in this connexion that the proposal made by the Madras Government, in 1871, of placing the budget before the provincial legislature was disallowed by the Government of India and the Secretrary of State.

all other authorities in that country must entirely defer.[1] Such authority can only be possessed by the Governor-General in Council, and in an extreme emergency, such authority must be understood to really centre in the Governor-General himself as the ultimate arbiter of affairs. In no other way can the financial means of the empire be husbanded and economised in time of peace. In no other way can the power of the empire be effectively wielded in time of danger." [2]

The scheme of decentralisation was referred by the Secretary of State to a Committee, the terms of reference being as follows: "(1) Should the Presidency Governments be allowed to manage

[1] He had evidently this in mind when he wrote: "Though I fully acknowledge the loyal support afforded by so many of the authorities in India, yet I cannot overlook the fact that even in some official quarters there is growing up a desire to be virtually independent of the Queen's representative in this country."

[2] He observed further: "And is not danger to India still possible? We may never have 1857 over again. But looking to the status of the great powers of the world, to the growth of their maritime, military, commercial, and political influence in the East, to public liabilities accruing more and more in India and sustained by the credit of the British Government, I can foresee possible combinations of troubles, widely different from those of 1857. If in such crisis the Governor-General in Council is really powerful he may steer the State through the breakers. But if he were only the head of a loose confederation of Local Governments that might yield him only a qualified obedience; or if there had been a decentralisation of finance, so that he was not really master of the national resources, then the dangers of such a time might be so aggravated that those concerned in India might tremble for the result, and that the immense interest connected with our Eastern Empire might be jeopardized."—*Minute dated the 23rd March, 1868.*

any, and what, portion of their local expenditure and of their local taxation, without reference to the Government of India? (2) Should any system of advances from the central to the local treasuries for Presidency purposes be introduced?" On the 23rd April, 1868, Sir Stafford Northcote, then Secretary of State for India, said in the House of Commons: "Mr. Massey has proposed a scheme by which local administration and objects may be promoted by the expenditure of local funds, raised on a system of local taxation. This is a matter difficult to manage, and we must be cautious, for it is better to be a year or two too long than to be precipitate in our proceedings. However, in the general principle of Mr. Massey's proposals I readily concur; and I hope it will not be long before something of the kind is carried into effect. We must take care that the solidity of Indian finances is not shaken, and we must provide safeguards against reckless expenditure. We have a system which has raised the credit of India to the highest pitch, and therefore I would be the last to disturb it, and would be slow and cautious in introducing any change."

The scheme of federal finance had the support of the majority in the Governor-General's Council, and was approved by all the provinces with the single exception of Madras. But the stubborn hostility of Sir John Lawrence, who was supported by Sir Henry Mortimer Durand and

Lord Napier of Merchistoun, stood in the way of the acceptance of the proposal.[1] It is idle to speculate now on the causes of the strong and unbending attitude taken up by Sir John towards the scheme. Perhaps his angle of vision had been distorted by the spirit of insubordination displayed by Sir Bartle Frere, Governor of Bombay. It is also possible that, while he did his best to maintain peace in India, he was always haunted by the spectre of war. It is a matter for infinite regret that a narrow and short-sighted view prevailed over an enlightened policy on a question of such importance. But perhaps the time was not yet ripe for the adoption of a system of federal finance. Federalism in financial matters can only co-exist with federalism

[1] It may be noted that, in 1868, Col. G. Chesney brought out his book on *Indian Polity*, in which he advocated a system of federal finance. He observed that the remedy for the evils of the then existing system would be found in investing the Provincial Governments with a share of financial responsibility. He suggested that the revenues of India, instead of being dealt with as one income, should be regarded as distinct provincial revenues. Each province, he said, should be charged with its quota of the general expenses of the empire, which it should be required to contribute to the imperial exchequer. The remainder of its income should be left at its own disposal. The imperial charges would be: (1) The home charges; (2) interest on debt; (3) establishment of the Government of India; (4) diplomatic establishments; (5) army; (6) imperial services, such as the post and telegraphs; (7) interest guaranteed on railway capital; (8) grants-in-aid to some of the poorer provinces. This reform was, in Col. Chesney's opinion, calculated to establish the relations of the superior and subordinate Governments on a just and rational footing.

in other spheres of governmental activity. In the sixties of the last century and for a long time afterwards, the Provincial Governments were merely the subordinate parts of an autocratic administration. The spirit of democracy was entirely absent from the administrative arrangements of the country, and self-government for the Indian people was still a far-off ideal. In such circumstances, a relaxation of central authority might have made the Provincial Governments even more autocratic than they actually were. On the other hand, it was not beyond the range of possibility that the acceptance of the federal principle in finance would itself have accelerated the pace of advance towards a federal system of government based on democratic principles.

The financial positions of the different parts of India stood thus towards the close of this period:—Government of India: revenue, £2,538,362; expenditure, £13,458,414; deficit, £10,920,052; Madras: revenue, £7,507,081; expenditure, £6,598,163; surplus, £908,918; Bombay: revenue, £9,437,772; expenditure, £8,440,429; surplus, £997,343; Bengal: revenue, £16,533,385; expenditure, £6,544,463; surplus, £9,988,922; North-Western Provinces: revenue, £5,817,449; expenditure, £2,947,345; surplus, £2,870,104; Oudh: revenue, £1,476,183; expenditure, £773,151; surplus, £703,032; Punjab: revenue, £3,434,015; expenditure,

£2,382,111; surplus, £1,051,904; Central Provinces: revenue, £1,074,515; expenditure, £1,185,656; deficit, £111,141; Berars: revenue, £645,335; expenditure, £555,841; surplus, £89,494; British Burma: revenue, £1,266,493; expenditure, £895,855; surplus, £370,638.[1]

Thus we find that all the provinces of India, after paying their own way, yielded surpluses[2] which were utilised for the purely imperial requirements of the Government of India. It should be noted in this connexion that, unlike the other provinces, Madras and Bombay maintained separate army establishments. The military charges of these two provinces should, therefore, be deducted from their provincial expenditure, in order to obtain a proper idea of their contributions to the Government of India. During the year 1868-69, the military charges in Madras amounted to £2,711,815, and in Bombay to £2,584,069. The real contributions of these two provinces towards central expenditure were thus £3,620,733 and £3,581,412 respectively. The contributions of the different provinces in proportion to their revenues stood as follows: Bengal, 60·4 per cent.; North-Western Provinces, 49·3; Madras, 48·2; Oudh, 47·6; Bombay, 37·9; Punjab, 30·6; British Burma, 21·3; Berars, 13·8; Central Provinces, *nil*.

[1] The figures are for the year 1868-69. Gross figures are given here.

[2] The Central Provinces alone showed deficits; but these were only in 1867-68 and 1868-69; in other years, it had small surpluses.

CHAPTER III

STEPS TOWARDS DECENTRALISATION

The question of provincial finance was not allowed to rest undisturbed for long. On the 7th November, 1868, Sir Richard Temple, the Finance Member, wrote a Memorandum on the subject. He observed that the finances of India must be under the complete and absolute command of the Government of India, even though a part was localised. This, in his opinion, was essential for the security of the public debt, and for the political safety of the empire. Besides, the revenues of the several Governments were so interlaced that it would be impossible to allot to each province only its own revenue. He was unwilling to recommend a plan to make over, absolutely, to Provincial Governments any specific heads or proportions of revenue and charge, because such a transfer would not be final, but would merely be a ground of claim for further transfers. Sir Richard Temple did not consider the then existing system bad or devoid of merits, but thought it might be improved. In order to give the Provincial Governments a more direct interest in their finances, he deemed it expedient to keep them better informed as to the reasons for

what was allowed or disallowed, and to establish a visible connexion between increase of revenue and increase of expenditure for administrative improvement. The Finance Member suggested that, in the first instance, the financial powers of the two full Governments of Madras and Bombay might be enlarged, so that, after reserving the existing contributions of Madras and Bombay towards imperial charges, including military and marine, the Governments of those Presidencies might be allowed to dispose, each year, of the remaining charges and revenues within their jurisdictions. But savings at the end of the year would lapse to the imperial revenue, and the Central Government's control over the higher salaries and over general rates of pay, would be reserved. By this arrangement, all increase of revenue within the Madras and Bombay Presidencies would accrue to the Provincial Governments, and those Governments would be relieved from contributing to the extinction of the deficit existing at the time and to future reductions of debt. Further, he agreed that the control of the Government of India over the details of "establishment" might be relaxed to some extent. But he would not allow the Provincial Governments to raise any public loans on the security of the general revenues.

This was just as much as Sir Richard was able to recommend at the time, but he gave the

assurance that he would put forth his best efforts for the successful execution of any scheme which might be adopted. In a Note submitted by the Financial Secretary, Mr. E. H. Lushington, it was pointed out that, under this scheme, out of the revenue of £48,580,000 (according to the budget of 1868-69), the Government of India would retain its full control over a sum of £40 millions, and exercise a modified control over the remainder. The two Presidency Governments would have at their disposal the following sums,—Madras, £3,695,000, and Bombay, £5,010,000.

Sir Richard Temple's proposals were of an extremely limited character, and they failed to excite any enthusiasm. Financial difficulties again led the Government to initiate a discussion of the subject in 1769. In December of that year, Sir John Strachey observed in the Legislative Council that the deficits and the uncertainties of Indian finance had not arisen from any failure in the resources of the empire, but were "the temporary accidents of an imperfectly developed financial system." He expressed the view that the difficulty could be removed if the principle was acted upon that the imperial resources were not to be expended for purely provincial purposes, and if some plan was adopted for giving the Provincial Governments real motives for economy. "It has been truly said," he observed, "that under the present system every Local Government has a purse to

draw upon of unlimited, because of unknown, depth. The Local Governments have now no financial responsibility, and no means of knowing what amount of money they may legitimately consider to be the income, and the measures by which their annual expenditure must be regulated. They see on every side the necessity for improvements, all of them perhaps involving fresh expenditure, and their constant—and I will add, under the existing system, justifiable and proper—desire, is to obtain for their own provinces and people as large a share as they can persuade the Government of India to give them out of the general revenues of the empire. I am satisfied that there will be no real economy, and no complete and really effective check on our constantly increasing expenditure, until there has been placed upon every Local Government a specific responsibility for maintaining an equilibrium between its income and expenditure."[1] In April of the following year, Sir John Strachey reverted to the subject, when he expressed his conviction that, until every Provincial Government had a certain income of its own, out of which it could provide a certain portion of the public expenditure, the finances of the Government of India would never be put in a satisfactory condition.[2]

[1] Speech of Sir J. Strachey in the Legislative Council on the 19th November, 1869.

[2] *Proceedings of the Legislative Council, dated the 5th April, 1870.*

The new Governor-General, Lord Mayo, felt convinced that a change of system was necessary. He expressed the view that the provision so far made for education, sanitation, buildings, and communications had been inadequate, and that increased taxation would be needed to carry out all these objects.[1] Sir Richard Temple, however, took a pessimistic view of the matter. He remarked that, after obtaining greater financial freedom than they enjoyed at the time, the Provincial Governments would have no golden road open to them which was not open to them already, or which was not open then to the Supreme Government. He also uttered a note of warning in the following words: "If the concession of financial freedom to the Local Governments were to lead to any considerable increase of local taxation, I should not regard the change of system as an unmixed good."[2]

On the 23rd June, 1870, Sir Richard Temple wrote a Minute which became the starting-point of a long discussion. He stated that the Government must be prepared to improve the financial position in 1870-71 by at least one million, or if it was decided to reduce the rate of the income-

[1] Lord Mayo added: "I believe that increased taxation would be much more palatable if it were levied under the control and sanction of local authorities, and if the people who paid it were made sensible, by daily experience, of the benefits they derived from such taxation." —Speech delivered in the Legislative Council, 5th April, 1870.

[2] *Proceedings of the Legislative Council, 1870.*

tax by two millions. Among other methods of meeting the difficulty, he suggested that some items of expenditure, amounting to a million or two millions, to be selected from the four heads,—jails, education, roads, and police,—might be removed from the Imperial budget, and made over to Provincial Governments, who would be left to meet the funds by provincial taxation. Sir Richard Temple was himself not an advocate of the measure, but he introduced the subject at the request of the Governor-General. Sir John Strachey recorded a Minute, in which he expressed the view that imperial charge, amounting to a million or three-quarters of a million sterling, could be easily transferred to the Provincial Governments by increasing the road cess. But he thought that the mere transfer of charge from imperial to provincial resources without increasing the responsibility and control of the Provincial Governments, was likely to stir up extreme irritation and opposition in the provinces. He, therefore, considered it essential that Provincial Governments should be vested with a reasonable amount of responsibility and control over the details of their own expenditure.

Lord Mayo said on this occasion: "I believe, as I have repeatedly said, that if we place administration of portions, both of our revenue and expenditure, in the hands of the Local Governments, it will lead to economy,

to increased responsibility, to the avoidance of much administrative difficulty, and above all, it will enable the rulers of the country gradually to institute, in various parts of the empire, something in the shape of local self-government, and will eventually tend to associate more and more the natives of this country in the conduct of public affairs." The Governor-General then gave a sketch of his scheme. He estimated that the budget for 1870-71 would be worse than that of 1869-70 by half a million, and that the reduction of the rate of the income-tax would occasion a further loss of one million. He, therefore, considered it necessary to reduce imperial expenditure to the extent of a million and a half by throwing the burden on provincial resources. Lord Mayo proposed that the charges under jails, education, roads, civil buildings, and police should be made over to the control of Provincial Governments, amounting in all, as in the accounts of 1869-70, to £4,514,332. To meet these charges, he suggested the transfer of the excise receipts of over £2,000,000 and a lump assignment of £1,500,000, leaving Provincial Governments to find the remaining million.[1]

[1] In concluding his sketch of the basis on which, in his opinion, imperial finance should for the future be conducted, he enumerated the following advantages of the scheme:

"Under it the burdens of the people would be very slightly,

Sir B. H. Ellis, a member of the Governor-General's Council, in his Minute of the 22nd July, 1870, deprecated a demand for heavy new taxation to relieve the imperial exchequer. The proposed local taxation would not be for purposes to be administered by the aid of the people who would pay the tax, and therefore, in his opinion, would not be really local. He expressed the view that the greatest caution should be exercised in requiring contributions for imperial finance from local taxes. Further, he recorded his opinion that the plan would be free from objection if the state of the finances admitted of the whole of the present total assignment under the five heads being made over to the Provincial Governments, leaving

almost inappreciably, increased during the ensuing year.

The Supreme Government would be relieved of a great amount of work, which it cannot for much longer adequately discharge.

Provincial authority would determine in what mode the growing wants of these people could be most easily provided for.

Seed will be sown which may ripen gradually into a system of Local Self-government.

Under proper instruction, control, supervision and publicity, I believe greater economy will be practised.

The relations between the Supreme and Local Governments, at present in a most unsatisfactory state, might be improved.

The danger of a recurrence to the past discreditable state of our finance will be considerably mitigated.

In case of disaster, of famine, or of war, increased Imperial taxation can be immediately insisted on.

National credit will be improved by removing from our Estimates the most variable and uncertain branches of expenditure."—*Minute dated the 23rd June, 1870.*

See also J. F. Finlay's *Memorandum on Provincial Financial Arrangements.*

them to provide by extra local taxation for any future improvements in the several branches of administration thus placed under their control. He urged that, in any case, the reduction in the assignment should be much less than a million.[1]

The matter was then discussed in the Council, and it was decided that the proposal should be referred to the Provincial Governments with certain modifications and explanations. The suggestion for transferring excise revenue was dropped. The heads of charge proposed to be transferred were: jails, registration, police, education, medical services (partly), printing, roads, and civil buildings. It was also proposed to make over the departmental receipts under all these heads. For the remainder of the net charge, a lump assignment for each province was suggested, which was calculated on the figures for 1870-71. The Provincial Governments were first to consider how far the deficiency in their total grant could be met by re-distribution among the several heads and by retrenchment, and were then to resort to local taxation, if necessary. Circulars were sent out to all the Provincial Governments explaining the scope of the scheme. The circular sent to Bengal contained the following significant remarks: "The plan thus set forth does not profess to remove all inequalities

[1] *Minute dated the 22nd July, 1870.*

which may now exist in the Provincial distribution of the Imperial grants for the services affected. But it will afford facilities to each Local Government for partially correcting any such inequalities by distributing the total amount assigned to it among the several heads affected as it may think best for the public service; the requirements of each department being sufficiently provided for. No suggestion for the remedy of any alleged unfairness in the assignments made to the several provinces can be discussed on the present occasion."[1] These proposals were based mainly on the financial necessities of the Government of India. But it was pointed out in the circulars that, apart from financial necessity, the change of system was, "on general grounds, expedient."[2]

The Provincial Governments, while they considered the assignments to be too small,[3] accepted the proposed measure as an improvement on the then existing system. Extensions in the scope of the scheme were, however, suggested, and objections were raised to additional taxation which it would be necessary to levy in order to meet

[1] Circular, dated the 17th August, 1870.

[2] *Ibid.*

[3] To this objection Sir Richard Temple replied that the assignments were really as much as could possibly be afforded, and that the Government of India was not likely to be able to afford more for some time to come. *Vide Speech in the Governor-General's Council, 1871.*

the then existing imperial expenditure.[1] But not much heed was paid to these suggestions. The scheme was put into its final shape, and a Resolution was issued by the Government of India to give effect to it.

[1] The Lieutenant-Governor of the United Provinces hailed the scheme with hope and confidence, but considered the assignment for almost each of the departments transferred to be insufficient. He suggested the transfer of excise revenue to the provinces. He further urged the establishment of a legislative council in the province before which the proposals for taxation might be placed. The Chief Commissioner of Oudh cordially approved of the scheme, and expressed the view that, although, strictly speaking, landholders were not liable to additional taxation for most of the services proposed to be transferred, they could fairly be called upon to bear their share of the general burden. The Government of Madras cordially accepted the scheme, but thought that the contribution required from the province could not be provided in full unless more heads of service were transferred. The Chief Commissioner of the Central Provinces expressed the opinion that the scheme was of great value, but it would be better if some revenue of an elastic character, such as excise or forest, were also to be transferred. He considered fresh taxation impracticable or inexpedient, and pointed out that the curtailment of the assignment to the province would lead to the discontinuance of the grants which had so far been made to the district boards and municipalities out of the *pandhri* tax. The Governor of the Bombay Presidency regarded the scheme, though imperfect, as most valuable and pregnant with the greatest advantages to the whole of India. But the main defect of the scheme was that, in place of a fixed allotment for expenditure, it did not make over to the provinces certain productive revenues. He concluded his Minute by expressing the hope that eventually the whole of the revenues would be made over to the Provincial Governments less an ample contribution towards Imperial charges. The members of the Executive Council of Bombay observed that fresh taxation was impracticable in the Presidency in the then existing depression of trade. The Chief Commissioner of Burma cordially accepted the scheme, but demurred to the retrenchment proposed for the province. He also deprecated additional taxation which was likely to create

In the Resolution[1] published on the 14th December, 1870, the Governor-General in Council

discontent, as the people did not distinguish between imperial and local taxation. He, however, thought that some of the then existing sources of revenue might be increased. The Lieutenant-Governor of the Punjab objected to the proposal put forward by the Government of India to get rid of a million of unpopular direct taxation of its own and to throw upon the Provincial Governments the onus—and with it the inevitable odium—of increasing the direct taxation of the provinces. He also expressed the apprehension that, there being no finality in the scheme, two or more millions of charge might at any future time be transferred to Provincial Governments, with a direction to meet it by fresh local taxation. The Lieutenant-Governor of Bengal, Sir William Grey, pointed out that Lord Mayo's scheme required Provincial Governments to meet one million of imperial charge by fresh local taxation, whilst the Home Department's letter of the 25th April, 1868, required them to provide, by local taxation, for increased outlay on education and roads. He remarked that, supposing the Provincial Governments were able to comply with the present requisition, they would not be in a position to spend one rupee more on education, jails, roads, police or civil buildings than they had so far expended. He expressed the opinion that the road cess being reserved for increased benefits to the people, it would be very inexpedient to introduce any other new taxation for the furtherance of the present scheme. He objected to direct taxation, and suggested that the salt duty might be enhanced to meet the deficit.

[1] In the preliminary portion of the Resolution, the system as it existed till the end of 1870 was described thus: "Under the present system, these (the Provincial) Governments have little liberty and but few motives for economy, in their expenditure; it lies with the Government of India to control the growth of charges to meet which it has to raise the revenue. The Local Governments are deeply interested in the welfare of the people confided to their care; and, not knowing the requirements of other parts of the country or of the Empire as a whole, they are liable, in their anxiety for administrative progress, to allow too little weight to fiscal considerations. On the other hand, the Government of India, being responsible for the general financial safety, is obliged to reject many demands, in themselves deserving of all encouragement, and is not always able to

expressed the view that it was desirable to enlarge the powers and responsibilities of the Governments of Presidencies and Provinces in respect of the public expenditure in some of the civil departments. He wrote: " The Supreme Government is not in a position to understand fully local requirements, nor has it the knowledge necessary for the successful development of local resources. Each province has special wants of its own, and may have means for supplying them which could not be appropriated for imperial purposes. A tax adapted to the circumstances of one part of the country may be distasteful or inapplicable elsewhere; and, everywhere, rates may be proper for provincial or local purposes which could not be taken for the imperial revenue."

It was further stated in the Resolution that it would have been satisfactory if the Government had been able to take the first step in the direction of enlarging the powers and responsibilities of the

distribute satisfactorily the resources actually available. Thus it happens that the Supreme and Local Governments regard from different points of view measures involving expenditure; and, the division of responsibility being ill-defined, there occur conflicts of opinion injurious to the public service. In order to avoid these conflicts, it is expedient that, as far as possible, the obligation to find the funds necessary for administrative improvements should rest upon the authority whose immediate duty it is to devise such measures. This was the more important, because existing Imperial resources will not suffice for the growing wants of the country."

[Resolution of the Government of India, dated the 14th December, 1870.]

Provincial Governments without charging upon provincial resources any part of the imperial expenditure. But this was considered impossible specially in view of the fact that the Government of India had already announced a reduction in the rate of the income-tax from the following year. It was decided that the following departments of administration, namely, jails, registration, police, education, medical services (except medical establishments), printing, roads, miscellaneous public improvements, and civil buildings were to be made over to the Provincial Governments. At the same time, a sum of £4,688,711, which was less by £330,801 than the assignments made for the same services in 1870-71, was to be granted permanently from the imperial revenue, for these services.

The actual imperial assignments for provincial services would thus be as follows:[1] Oudh, £206,948; Central Provinces, £261,263; Burma, £275,332; Bengal, £1,168,592; North-Western Provinces, £640,792; Punjab, £516,221; Madras, £739,488; Bombay, £880,075; Total, £4,688,711.[2]

[1] In calculating these allotments, a sum of £350,000 was deducted rateably from the grants made to the several provinces in 1870-71; but it was thought expedient to remit the deduction (£19,199) which would fall upon British Burma, the circumstances of that province being exceptional. No additional deduction was made for the other provinces in consequence of this concession to Burma.

[2] The imperial financial year was to be the year of account for the provinces.

All receipts in connection with the provincial services were to be given up to the provinces in which they accrued. The total direct saving to imperial revenues was £330,800. It was decided that each Provincial Government would publish its own yearly estimates and accounts in the provincial gazette, together with a financial exposition (which should, where possible, be made before the provincial legislative council) analogous to that made in the legislative council of the Governor-General. In the financial statement and accounts of the Government of India, the assignments were to appear under a single head "Provincial Services."[1] Any unspent portion of the assignment was to be carried forward to the credit of the Provincial Government for expenditure in the following year at its discretion. The assignments thus made were to be permanent.[2]

The financial control which was thus entrusted to the Provincial Governments was to be exercised subject to the following conditions: First, without

[1] The estimates and accounts were prepared in accordance with this decision from 1871-72 to 1877-78. But the old system was reverted to in 1878-79. From that date the details of provincial revenue and expenditure were once more included in the budget and accounts of the Government of India.

[2] Paragraph 17 of the Resolution reads as follows: "Unless some fiscal misfortune, such as a heavy loss in the opium revenue, or national disaster, such as war or severe famine, occurs, the Governor-General in Council will maintain for the future assignments for provincial services at the amounts now fixed. They will not, in any case, be reduced without previous consultation with the Governments."

the previous sanction of the Government of India, (*i*) no appointment was to be created with a salary of more than 250 rupees a month; and no addition was to be made to the pay and allowances of any officer if they exceeded Rs. 250 a month; (*ii*) no class or grade of officers was to be created or abolished, and the pay of no class or grade of officers was to be raised; (*iii*) no addition was to be made to the pay or allowances of any individual or class of officers, that might lead to increase in the emoluments of any public servants doing duty in the same province, whose pay and allowances were charged to the imperial revenues; (*iv*) no moneys were to be removed from the public treasuries for investment; (*v*) no services rendered to other departments by the departments now transferred to the control of the Provincial Governments were to be diminished, nor were any services rendered to these departments by the departments left with the Government of India were to be increased. Secondly, the rules of the Supreme Government in respect of leave and absentee, deputation, and superannuation allowances were to be observed. Thirdly, returns, accounts and estimates were to be submitted to the Supreme Government in such forms and at such times as might be prescribed.[1]

The Governor-General in Council expressed his belief that the change would produce greater

[1] *Resolution dated the 14th December, 1870.*

care and economy, that it would impart an element of certainty into the fiscal system which had hitherto been absent, and that it would lead to more harmony in action and feeling between the Supreme and Provincial Governments than had so far prevailed. But, beyond all this, there was a greater and wider object in view. "Local interest, supervision, and care," wrote the Governor-General in Council, "are necessary to success in the management of funds devoted to education, sanitation, medical charity and local public works. The operation of this resolution in its full meaning and integrity will afford opportunities for the development of Self-government, for strengthening municipal institutions, and for the association of natives and Europeans, to a greater extent than heretofore, in the administration of affairs."

It was decided to confine the interference of the Supreme Government in the administration of the provincial services to what would be necessary for the discharge of that responsibility which the Governor-General in Council owed to the Queen and her ministers. Intervention might also be necessary for the purpose of securing adherence to the financial conditions prescribed, and to the general policy of the Government of India. Subject to these general restrictions, it was decided that the Provincial Governments would henceforth enjoy full liberty in the expenditure of the funds

appropriated to "Provincial Services." The concluding words of the Resolution are worth noticing. "It must, however, be understood," it was observed, "that in thus divesting himself of control the Governor-General in Council divests himself also to a large extent of his former responsibility. If responsibility for expenditure is retained, control cannot be renounced."

The Secretary of State, in communicating his approval of the measure, observed that the great objects to be kept in view should be to "secure the greatest degree of economy consistent with efficiency," and "to provide for the growing demands arising out of improved administration without materially increasing the burdens of the people." In regard to the latter aim he added: "I am specially anxious that, when devising measures of improvement, it should be the earnest endeavour of each Local Government to provide the funds required for them by the exercise of strict economy in their expenditure, and that additional taxation should only be resorted to in cases of undoubted necessity and when the income otherwise available is clearly insufficient."[1]

Let us now consider the merits and defects of the scheme. That a change was needed in the financial system was admitted by all. But if we carefully analyse the system of financial decentral isation as adopted in 1870, we find that it did

[1] *Despatch dated the 23rd February, 1871.*

not introduce any changes of a far-reaching character. It failed to embody the great principles which had been enunciated by Mr. Samuel Laing and Mr. Massey. The actual scope of Lord Mayo's measure was far more restricted than that of the scheme of federal finance advocated in 1867-68. Its aim also fell much shorter than that of the former scheme. Although the desirability of investing the Provincial Governments with larger powers and responsibilities was stated in the Government Resolution to be the main object of the change, it was in reality the necessity for affording relief to imperial finance that led to its adoption.

As for the effects of the new system, it is clear that, while it put a check to the demands of the Provincial Governments on the central exchequer, it did not provide any real motive for economy in financial administration. The new system merely shifted the responsibility for expenditure under certain heads from the Governor-General in Council to the Provincial Governments.[1] The Government of India kept all the

[1] As Sir George Campbell, Lieutenant-Governor of Bengal, pointed out, equilibrium in the finances of the Government of India was obtained by throwing a portion of the burden on the Provincial Governments, and telling them to make up the small deficit now assigned to them and the larger deficit that must accrue in future years. He also remarked that, as the servant was sometimes more zealous than his master, some gentlemen had attempted to explain away this view of the case, and tried to make out that there was no

sources of revenue for imperial purposes including those which were of a rapidly expanding character, but the burden of increasing charges was thrown on the provinces. As the Provincial Governments were permitted to supplement their income by provincial taxation, the change did not necessarily make for economical management of the available resources. Besides, the assignments were so small in amount that the Provincial Governments were faced with the alternative either of retrenchment in useful expenditure or of additional taxation. As retrenchment was hardly practicable in the departments transferred to the provinces, the levy of fresh taxes was the only available solution of the difficulty.

As a matter of fact, the levy of a considerable amount of taxation was found necessary soon after the introduction of the system of provincial decentralisation. In Bombay, two new taxes were proposed for the purpose of meeting the deficit in the provincial budget.[1] Sir Seymour Fitzgerald, in introducing these measures in the Bombay Legislative Council, said distinctly that he deplored the necessity of proposing additional taxation, but as the Government of India had reduced the grant to the Presidency, he must

burden on the Provincial Governments at all. *Vide Speech in the Governor-General's Council, 27th March, 1871.*

[1] These were (1) a tax on feasts and (2) a tax on the non-agricultural rural population. The former proposal was dropped, but the latter was given effect to.

"either starve the local services or find the money somehow."[1] In most of the other provinces also, additional taxation was levied about this time. It was maintained by some high officers of the Government that there was no necessary connexion between the decentralisation order and local taxation.[2] Whatever truth there may be in this view, the fact cannot be denied that the years immediately following the adoption of the new system of provincial finance witnessed the imposition of additional taxes almost throughout the country.[3] Not long after this step had been taken, provincial finance formed one of the subjects of investigation by a Parliamentary Select Committee. In tendering evidence before this body Lieut.-General Richard Strachey expressed the view that the new system was not responsible for local taxation, as it had not conferred any additional powers of taxation on the Provincial

[1] *Proceedings of the Legislative Council of Bombay, 1871.*

[2] *Vide Evidence before the Select Committee, 1872.*

[3] Sir George Campbell said: "We could not carry on the departments made over to us on the very reduced scale which now prevailed; still less could we provide for a fairly liberal normal expenditure; least of all, could we provide for the growth of the departments which naturally grew, and were meant to grow, for the benefit of the people. None of these things could we manage without doing one of two things; either raising more money by provincial taxation for provincial purposes, or throwing upon local cesses a part of the charges hitherto imperial and now provincial." On another occasion he observed: "It put the Local Governments in this position that the Government of India taxed the rich, and we taxed the poor and, between us, we taxed every one."

Governments.[1] He also said that while, on the one hand, additional taxes were levied by the Provincial Governments, there was, on the other, a diminution of imperial taxation. It was pointed out, however, by one of the members of the Select Committee that the remission of the million and a half of the income-tax was due to the fact that an excessively high rate had been imposed suddenly to meet a financial emergency without the intention of its being continued longer than was absolutely necessary; nor could, in his opinion, any connexion be traced between the remission of imperial taxation and the levy of local taxes. It is much to be regretted that high officers of the Government forgot that the remission of the income-tax gave relief to the comparatively well-to-do, while the provincial taxes increased the burden on the poor. As a matter of fact, it would have been much better to keep the income-tax a little higher than

[1] *Evidence before the Select Committee, 1872.* The same view was expressed in "*The Finances and Public Works of India,*" a work prepared jointly by Sir John, and Lt.-General Richard, Strachey. They wrote: "The Local Governments obtained no powers of taxation which they did not possess before, and excepting in the North-Western Provinces, Punjab and Oudh, where new rates for local purposes were imposed to a very moderate extent, the measures of 1870 led to no fresh taxation. It is true that a considerable increase in the local taxation was made about the same time in Bengal, Madras and Bombay, but this was an accidental coincidence and had no connexion whatever with the introduction of the new system of administration and finance."

to compel the Provincial Governments to levy fresh taxes at the very commencement of the new system.

A word may be said about the comparative advantages reaped from the changed system by the Government of India and the Provincial Governments.[1] That the measure was beneficial to the Government of India could not admit of a shadow of doubt. It set a definite limit to the expenditure of the Central Government on subjects which demanded continually increasing outlay; while the augmentation of the revenues was not to be shared with the provinces. The Provincial Governments appreciated the relaxation of the vexatious policy of interference in every minute detail of expenditure. For the moment the new system tended to diminish the old friction between the Central and Provincial Governments and produce greater harmony between them. But this effect was merely temporary. Sir John Strachey seems to have gone too far when he asserted that every object with which the change of system had been made was more or less gained.

The actual distribution of the provincial assignments gave rise to dissatisfaction in most of the

[1] Sir Richard Temple said: "But let all this eventuate as it may, sure I am, with certainty free from shade of doubt, that the measure is advantageous to the imperial Budget of British India."—*Financial Statement, 1871-72.*

provinces. For the purpose of allocation, as was pointed out by Lord Napier of Merchistoun,[1] the Government of India simply accepted the financial basis as it stood at the moment. They gave to each province the amount of appropriation which it had received in the previous year, making small deductions from all of them. This settlement had the advantage of eluding opposition and securing promptitude, and avoided all thorny discussions. But the division of resources was unequal.[2] Lord Napier expressed the view

[1] He was the Acting Governor-General at this time. Before terminating his connexion with the Indian administration, Lord Napier thought it fit to leave on record an expression of his views regarding the scheme of provincial finance. He observed that Lord Mayo's scheme had been a "positive and fruitful benefit to the Government of India and the subordinate Governments." He went further and suggested that additional departments should be made over to the Provincial Governments. A great change had thus occurred in his attitude since 1868.

[2] Lord Napier of Merchistoun rightly observed that the appropriation of imperial revenue under the heads included in 1870 in the category of the Provincial Services had been in some degree "unsettled and arbitrary" before the institution of the new system. He said: "Some parts of the Empire had been more advanced, intelligent, ambitious, and clamorous than others; they got much because they asked much. Other parts of the country were rude, backward, or lately reduced to submission; they got much because they needed much, because they had a claim on the fostering care of the Government of India, which recognised that conquest has its duties as well as its rights; nor were perhaps, reminiscences and attachments of men in power without influence." Lord Napier prepared a table of provincial revenues from which he calculated that the provincial assignments varied, having regard to the revenues of the several provinces, from 10·355 in the case of Madras to 31·679 per cent. in the case of Burma.—*Minute dated the 3rd May, 1872.*

that any distribution which was made without reference to the revenues or the population of the provinces concerned was bound to involve injustice. He, therefore, suggested that the provincial assignments should be fixed for all the provinces at a normal rate of $12\frac{1}{2}$ per cent. on their respective revenues, excluding customs and opium.

Sir Richard Temple, the Finance Member, admitted that there had been some unavoidable inequality ; but he feared that, if the matter was stirred, there would arise a long series of disputes which would never be satisfacforily settled. He, however, thought that the facts pointed out by Lord Napier should be borne in mind and considered whenever anything additional was to be given to the provincial.[1]

Sir John Strachey did not deny that there had been inequalities in the treatment of the different provinces. But he was unable to assent to the proposition that the assignment to any province should bear a certain proportion to the amount which that province contributed to the general revenues of India. He refused to accept the view that the expenditure in each province should be regulated not by its actual wants, nor by

[1] Sir Richard Temple added: "Though we cannot properly take away, we can give as we see fit, without any other party having a right to cavil. And, in the future, I would try so to distribute the gifts (if there be any) among the Local Governments as to remedy any existing inequalities."—*Minute dated the 9th July, 1872.*

the means at the disposal of the Imperial Government, but by the amount of its actual local revenue. Sir John observed: "I think it would be quite impossible to carry on the government on any such principle. The Empire must be treated as a whole; not as a collection of separate and semi-independent States." He remarked further : " The distinction between imperial and provincial expenditure is one which it is convenient, for certain practical purposes, to make ; but it is, in reality, purely arbitrary...Whether expenditure be called imperial or provincial, actual requirements and actual means of meeting them can alone determine the amount which the Government of India can properly grant. The object at which the Government aimed, in introducing the new system of provincial assignments, was not to attempt the task of making a theoretically equitable distribution of imperial revenues between the various provinces, but to make better practical arrangements for meeting actually existing charges."[1] If evidence was wanted of the narrow scope of Lord Mayo's measure, these words of an eminent administrator furnished it in ample measure.

The Minute of the Acting Governor-General started a discussion in 1872 as to the desirability of further extending the system of provincial assignments and considering whether the system

[1] *Minute dated the 27th July, 1872.*

could be applied to any sources of revenue. On this occasion, Sir John Strachey expressed the view that the Government of India was not in a position to devote any proper care to the development and administration of those branches of revenue which depended entirely, for their management and collection, on the local authorities. He said: "I think it certain that the authorities who administer the revenues ought to be made practically responsible for doing so in the best manner possible ; and this responsibility will not be really felt until the Local Governments find that, while bad administration of the revenues led to their own injury, good administration gives them increased means of carrying out the improvements which their provinces require. They have now no personal inducement (so to speak) to develop the public revenues ; and this inducement ought to be given to them."[1] No further steps were, however, taken during the next five years towards extending the system.

In submitting their reports on the operation of Lord Mayo's measure during the years 1872 and 1873, the Provincial Governments pointed out its defects and limitations, so far as it affected their respective provinces. The Governor in Council of Madras observed that the general results of the measure had been favourable, but

[1] *Minute dated the 27th July, 1872.*

urged that more departments should be transferred and that inequalities in assignments should be corrected.[1] The Governor of Bombay was dubious as to the success of the decentralisation measure.[2] He expressed his strong dislike of provincial taxation, and urged that a certain percentage of the revenues of their respective territories should be made over to the Provincial Governments. The members of his Council, while concurring in the view that the Government of India should be asked for a percentage of the revenues, thought that a reversion to the old system would be a retrograde step.

Sir George Campbell, Lieutenant-Governor of Bengal, observed, that the assignments, prior to Lord Mayo's measure, had been made with more regard to the pertinacity and boldness of the Provincial Governments than to their relative population and territory, and had consequently been unequal. The expenditure allowed in Bengal under the heads, police, education, and public works had been much smaller than that allowed in the other provinces, in proportion to population. As the assignment of 1870 had been based on the previous assignments, less a considerable sum, a great deal of financial difficulty had been apprehended. But by observing economy and retrenchment, it had been

[1] *Letter dated the 9th January, 1873.*
[2] *Letter dated the 31st December, 1872.*

found possible to make thet wo ends meet, and thus avoid additional taxation. He suggested that the income-tax should be transferred to the provinces. In concluding the subject, the Lieutenant-Governor said that the wisdom and practical efficiency of the system had been manifest.[1]

The Lieutenant-Governor of the North-Western Provinces observed that the system had worked well, but its defect lay in its inelasticity. He, therefore, urged that in future a fixed allotment be transferred with the services, besides a share in the growth of provincial revenues over a normal amount of such revenue.[2] The Government of the Punjab thought that the decentralisation system had worked successfully, but the fixed character of the provincial allotment was a blot on it, which should be removed by granting to each Provincial Government a percentage of the general revenue of the province. The Chief Commissioner of Oudh said that the scheme had generally worked well.[3] The Chief Commissioner of the Central Provinces expressed the opinion that the system of fixed assignments detracted seriously from the value of the scheme. The people, he said, would not be made to contribute more than a certain amount in the way of taxes, whether they were called imperial or provincial.

[1] *Letter dated the 13th December, 1872.*

[2] *Letter dated the 25th December, 1872.*

[3] *Letter dated the 10th December, 1872.*

He, therefore, suggested that all revenue, less a portion for meeting imperial charges, should be made provincial. In case, however, the Government of India should be unwilling to take so great a step, the Chief Commissioner urged that the Provincial Governments should be allowed some heads of revenue or a share in the growth of resources.[1]

A brief account of the assigned revenues of the Provincial Governments and their expenditure upon the delegated services during the period 1871-76 will perhaps be found interesting. The Government of India inaugurated the provincial system by granting to the provinces balances aggregating Rs. 20 lakhs. Their receipts in the five years, including provincial contributions, aggregated a little over Rs. 30 crores. The expenditure upon the delegated services amounted to Rs. 30 crores. The total balance of the Provincial Governments on the 31st March, 1876, was Rs. 29½ lakhs.[2]

[1] *Letter dated the 27th November, 1872.*

[2] The detailed figures were as follows:—

	Rs.		Rs.
Opening Balance, 1st April, 1871 ...	20,00,000	Expenditure on Transferred Services ...	30,03,76,338
Assigned Revenues ...	4,13,05,938	Closing Balance, 31st March, 1876 ...	29,48,890
Attotments from imperial revenues ...	25,44,25,630		
Provincial Contributions	55,93,660		
Total ...	30,33,25,228	Total ...	30,33,25,228

Vide Financial Statement, 1877-78.

The financial embarrassment of the Government of India, was the occasion for taking the second step towards a policy of provincial finance. In 1877, Sir John Strachey, then Finance Member of the Government of India, finding it necessary to improve the revenues of the country, recalled the words of Mr. John Bright about the decentralisation of the Indian Government. He felt convinced that a further step in this direction, leading inevitably to improved administration, would bring about a great increase in the productiveness of the existing sources of revenue, a great diminution of the evils of fresh taxation,—if fresh taxation became necessary,—and a great economy in expenditure. Experience, he observed, had shown that the results of the system introduced in 1871 had been thoroughly satisfactory. While objections had been made to some of the details, and Provincial Governments had often said that the change had not gone nearly far enough, neither the Government of India nor any Provincial Government had felt a doubt as to the correctness of the main principle or the general success of the new arrangements.[1] He did not forget to

[1] Sir John Strachey added: "Every object with which the change of system was made has more or less been gained: the old friction between the Supreme and Local Governments has been greatly diminished ; the authority of the Supreme Government and its powers of general control, instead of being weakened, have become stronger and more real ; since the attempt to interfere in all sorts of petty details was abandoned, the Local Governments have been able to carry out

emphasise the fact that imperial finance had derived substantial benefit from these arrangements.

But the weak point in these measures, in the opinion of Sir John Strachey, was that, while they transferred to the Provincial Governments the responsibility for meeting charges which had an undoubted tendency to increase, the income placed at the disposal of the Provincial Governments had little room for development. Sir John Strachey, therefore, thought that the system of provincial assignments ought to be applied not only to expenditure but also to income. "What we have to do," said the Finance Member, "is not to give to the Local Governments fresh powers of taxation, but, on the contrary, to do all that we can to render fresh taxation unnecessary, and to give to those Governments direct inducements to improve those sources of existing revenue which depend for their productiveness on good administration."[1] This could only be done by giving to the Local Governments, which had in their hands the actual working of

many measures of improvement which would otherwise have been impracticable; and so far as I know there has not been a single counterbalancing disadvantage."—*Financial Statement, 1877-78.*

[1] The Finance Member took as an example the two great heads of 'excise' and 'stamps,' the administration of which, though centralised in the Government of India, had to be carried on by the officers of the Local Governments; the evasion of these taxes was notorious, but he hoped that better administration would give a large additional revenue without the country feeling that any new burdens had been imposed upon it.

the great branches of the revenue, a direct and almost personal interest in efficient management.

Another defect of the system of 1870 was that the services in which the provinces were given a financial interest were relatively few. A further development of the system was thus urgently called for. Such development had, in fact, been foreshadowed by Lord Mayo, the author of the first measure of decentralisation. He had made the significant observation in 1871: "At some future time, it may be thought desirable to apportion certain heads of revenue to local authorities reducing proportionately their grants." [1] Time had now come for the fulfilment of this promise. In a letter addressed to the Secretary to the Government of the North-Western Provinces in 1877, the Governor-General in Council suggested that the management of certain heads of revenue might with advantage be transferred to the Provincial Governments. A similar letter was also addressed to the Government of Bengal.[2] As a result of this correspondence, fresh settlements were made

[1] This seems, indeed, to have been Lord Mayo's original intention. But he refrained from making the suggestion in 1870 because he thought " the result would have been a failure," as His Majesty's Government would, very properly, have required a much longer time " to consider a change of so extensive and fundamental a nature."—*Vide* Speech in the Legislative Council, 18th March, 1871.

[2] The letter ran in part thus: " The revenue from excise, stamps, and law and justice will thus be surrendered for the next five years; thereafter, the whole arrangement will be subject to revision; and the Governor-General in Council must, then, probably claim for the

with these provinces in 1877. These settlements assigned to the Provincial Governments financial control over services connected with general administration, land revenue, excise, stamps, and law and justice, and at the same time gave them the revenues raised from law and justice, excise, stamps, and some miscellaneous items.[1] The responsibility for constructing public works for local and provincial purposes was also transferred to the provinces. Similar settlements were made with Oudh, the Punjab, the Central Provinces, and Bombay in the course of the next year. Madras alone refused to accept the new system and preferred to continue the settlement of 1871. The settlements were subject to the condition that no Provincial Government was to exhaust the balance at its credit with the Government of India or infringe rules and restrictions prescribed by the latter.

imperial revenues a share of any improvement which may ensue under the management of the Local Government in excess of the stipulated annual increments belonging to the imperial treasury."—*Letter dated the 29th March, 1877.*

[1] It was arranged with the Government of the North-Western Provinces that, for the next two years, one half of any net increase that might arise would belong to the Government of India and the other half to the Provincial Government. In regard to Bengal, inasmuch as a considerable burden was imposed upon the province in order to guarantee to the imperial revenues the interest on the capital spent in Bengal on the construction of canals and railways, the Government of India, for the moment, decided to abstain from claiming any part of the further increase which might accrue to these revenues in consequence of the greater attention which they were expected to receive from the Provincial Government.

The system, thus expanded, was an improvement upon that introduced by Lord Mayo in 1871. But it did not go far enough. It did not give the Provincial Governments an inducement to develop any revenues other than those covered by the assigned heads. But these revenues were far from sufficient to meet their liabilities. The result was that the incomes of the Provincial Governments had to be largely supplemented by fixed grants.

These measures were highly beneficial to the Government of India. The immediate annual saving to the imperial treasury as the result of the arrangements entered into with Bengal, the North-Western Provinces and Oudh was £101,700, besides the guarantee of normal increases in the transferred revenues, amounting to an annual sum of £44,000. It was further estimated that, when complete, they would improve the financial position of the Central Government by an annual sum of about £400,000. Considerable satisfaction was expressed by the Governor-General in Council at the fact that this improvement was not due to fresh taxation, but was the result of a policy of administrative and financial decentralisation.[1] The Provincial Governments, though not satisfied with the exact terms of these settlements, appreciated the more independent position offered to them and

[1] *Resolution of the Government of India, dated the 18th March, 1878.*

began to take a greater interest in the development of the revenues placed under their control.[1]

In 1878-79, the arrangements with British Burma and Assam were revised and greatly expanded. A new feature in the arrangement with these provinces was that in place of a fixed allotment, a share of the reserved imperial revenues was assigned to them, so that the provinces might participate in any improvement of these revenues.

Another matter which affected provincial finance during this year deserves notice. The financial necessities caused by the Afghan War

[1] The Government of Bengal reported as follows: "The Lieutenant-Governor has found that the general effect of the extension of the decentralisation system in respect to the facilities which it has given to provincial administration has been even more satisfactory than he anticipated. In making the Local Governments responsible for expenditure and giving them a direct interest in the development of the various branches of the revenue, it has secured a careful scrutiny over the expenditure of all departments, and a deep interest in all improvable heads of revenue which has extended to all grades of the services. District officers understand that the Provincial Government can sanction no new schemes and few new works unless it has a constantly improving revenue, and they have shown an earnest desire to assist the Government by the adoption of every measure which their local experience suggests as likely to have a beneficial effect upon the revenues. At the same time the Local Government has, since the inauguration of the system of provincial finance in 1870-71, been in a position to carry out many works and many measures of improvement on its own responsibility, which would, under the old system, have possibly been delayed for an indefinite period. All friction with the Imperial Government has been obviated and much useless and unnecessary correspondence avoided."—*Letter from the Government of Bengal to the Government of India, dated the 14th December, 1877.*

led the Government of India to place severe restrictions on expenditure in all the provinces. Later in the year, it called upon each of the Provincial Governments to surrender to the Central Government a portion of its provincial assignment for the year 1880-81. The amounts which these Governments agreed to surrender were as follows: Bengal, 20 lakhs ; North-Western Provinces and Oudh, 15 lakhs ; Bombay, 8 lakhs; Madras, 8 lakhs; Punjab, 6 lakhs; British Burma (about) 6 lakhs;[1] Central Provinces, 5 lakhs; Assam (about) 3 lakhs; total, 71 lakhs. It was also arranged that savings effected by the reduction of public works establishments in the provinces should accrue to the imperial treasury.

[1] *Resolution dated the 6th November, 1879.* The amount actually contributed by Madras was only 4 lakhs.

CHAPTER IV

PROVINCIAL CONTRACTS

The settlements made with the Provincial Governments between the years 1877 and 1880 were generally for short terms, and were to expire in or before the year 1882. On the 30th September, 1881, an important Resolution was published by the Government of India on the extension of provincial finance. In accordance with this Resolution, fresh settlements were made with all the provinces. The most important principle accepted in these settlements was that, instead of giving Provincial Governments a fixed sum of money to make good any excess of provincialised expenditure over provincialised receipts, a certain proportion of the imperial revenue of each province was devoted to this object. Certain heads, as few in number as possible, were, wholly or with minute local exceptions, reserved as imperial; others were divided, in proportions for the most part equal, between the Imperial and Provincial Governments; the rest were wholly, or with minute local exceptions, made provincial. The receipts from customs, salt, opium, post office and telegraphs remained wholly imperial. The income from forests,

excise, license-tax, stamps, and registration was divided equally between the Government of India and the provinces; while the revenue collected under the head 'provincial rates' was made entirely provincial and local. The receipts from law and justice, public works, and education were also provincialised. The bulk of the income from railways and irrigation remained imperial. The division of liabilities for expenditure followed, generally speaking, the incidence of the corresponding heads of receipts. The balance of transfers being against the Provincial Governments, it was rectified for each province by a fixed percentage on its land revenue (otherwise reserved as imperial), except in Burma, where the percentage was extended also to the rice export duty and the salt tax. The advantage of this system over that which it superseded was that the Provincial Governments were given a direct interest, not only in the provincialised revenue, but also in the most important item of imperial revenue raised within their jurisdiction.

Another important change effected on this occasion was that, in modification of the reservation which had been in force since 1871 regarding extraordinary expenditure, it was declared, on the one hand, that the Provincial Governments must not look for any special aid from the Imperial Government except in the case of a severe famine (and then within well-defined

limits), and on the other, that the Imperial Government would make no demand on them except in the case of a disaster so abormal as to exhaust the imperial reserves and resources, and to necessitate a suspension of the entire machinery of public improvement throughout the empire.

One other matter dealt with in this Resolution deserves notice. It was urged that provincial agreements should no longer exclude from all consideration the mass of taxation under local and municipal management, together with similar resources still retained under provincial control. The Resolution went on to say: "The Provincial Governments, while being now largely endowed from imperial sources, may well, in their turn, hand over to local self-government considerable revenues, at present kept in their own hands, but similar in kind to many which have been 'locally' managed with success by committees, partly composed of non-official members, and subject only to a remedial control reserved to the State by the legislature." [1]

[1] The Resolution concluded with these significant words: "While thus inviting the Local Governments to assume new obligations, the Government of India has assigned to them, simultaneously, the means of discharging these obligations. The prospects of the revenues which it is proposed to divide between the Central and Local Governments, as well as those which will be exclusively provincial, are good, and the details of the administration will be so completely in the hands of the Local Governments, that they will be able effectually to promote economy as well as to develop the revenues. Their share of the increased revenues will be at their free disposal, subject always to standing rules to be made from time to time."

The general result of these arrangements was, as explained by the Finance Member, Sir Evelyn Baring, that three-fifths of the revenue of British India, amounting, roughly, to £42 millions, and about one-fourth of the expenditure, amounting roughly to £19 millions, would be provincialised; that is to say, the Provincial Governments would have, to a greater or less extent, according to the circumstance of each, an interest in, and responsibility for, their administration. Sir Evelyn added: "To be more explicit, they will receive the whole of the revenue under heads which produce about £4,000,000, half of the revenue under heads which produce about £8,000,000, a larger or smaller percentage on heads (chiefly land revenue) which produce about £23,000,000, and an almost nominal share in revenues which produce £7,000,000; while they will administer the expenditure wholly under heads for which grants amount to about £15,000,000, and to a very small extent under heads for which the grants amount to £4,000,000." [1]

Coming to the financial aspect of the settlements of 1882, we find that the Government of India resumed provincial revenues to the extent of £470,000 a year. But it also made certain grants

[1] *Financial Statement, 1882-83.*

to the provinces for definite purposes.[1] A considerable amount of taxation was also remitted about this time. Sir Evelyn Baring calculated that these grants and remissions totalled a sum of £496,000 a year. The net result of the arrangements was thus, according to him, a loss to the Imperial Government of £26,000 a year. He also expressed the view that an element of stability was now imparted to provincial finance which imperial finance did not possess.[2] "Not only," said Sir Evelyn, "do the three points, namely,

[1] The details of these grants and remissions were as follows: £77,000 granted to the Provincial Government for improving the position of the subordinate civil services and for general purposes in the Central Provinces, etc., £20,000 to the Government of Madras for provincial public works, £10,000 for additional *kanungoes* in Oudh, and £316,000 to the North-Western Provinces and Oudh in the form of remission of taxation. In addition, the Government of India remitted a lump sum of £360,000, equivalent to £72,000 a year for five years, on account of the first year of the new settlements, by means of a transfer to the provincial account of Bengal (£285,000), Burma (£20,000), and the North-Western Provinces (£55,000). *Vide Budget Speech of Sir Evelyn Baring, 1882.*

[2] But Sir Evelyn did not regret that this was so, for he observed: "It is the Provincial Governments, and not the Government of India, who are brought into immediate contact with the people. They supervise the whole of the administrative work of the country. Through their instrumentality, and through agency working in close connexion with their officers, most of the smaller, and some of the larger, public works are executed. It is a distinct advantage that, should any sudden emergency arise, such as war, a diminution of opium revenue, or a further depreciation in the value of silver, the Provincial Governments should be able to feel that the progress of any administrative reforms they may have undertaken, or the execution of any public works for which provincial funds are available, will not be checked."—*Speech in the Legislative Council, 1882.*

war, diminution of opium revenue, and depreciation in the value of silver constitute dangers which are wholly borne by the Government of India, not only does the fourth danger, namely, famine, naturally affect imperial as well as provincial finance, but if any further fiscal reforms are to be made, any loss of money which may accrue from this exemption is to be borne by the imperial treasury."[1]

During the first year of the new arrangements, provincial revenue and expenditure stood as follows:—Bengal: revenue, £4,086,872; expenditure, £4,600,292; deficit, £539,611; Bombay: revenue, £3,399,295; expenditure, £3,350,895; deficit, £149,894; Madras: revenue, £2,305,591; expenditure, £2,343,300; surplus, £108,421; North-Western Provinces: revenue, £2,881, 160; expenditure, £2,756,157 ; deficit, £281,222; Punjab: revenue, £1,352,692; expenditure, £1,382,161; deficit, £110,966; Central Provinces: revenue, £733,597; expenditure, £99,822; surplus, £33,775; Assam: revenue, £423,672; expenditure, £362,485; surplus, £13,887; Burma: revenue, £1,151,908; expenditure, £1,149,608; deficit, £171,207. The result of the new system was thus very unfavourable to the provinces, as, out of nine provinces, no less than six exhibited deficits during the year 1882-83.

[1] *Speech in the Legislative Council, 1883.*

The deficit of Bengal exceeded half a million pounds sterling, while the total deficit of all the provinces was no less than £1,096,817.

The settlements of 1882 were made for a period of five years. During the years 1882-83 and 1883-84, the financial position of the Government of India showed signs of solvency. It was, therefore, decided to refund the provincial balances appropriated by the Government of India in 1878-79 and also to withdraw the checks imposed on provincial expenditure. The substantial balances accumulated during the period of enforced saving, as well as the amount of £670,000 received back from the Central Government, now enabled the Provincial Governments to undertake works of public utility. In some cases, however, the possession of considerable sums led the Provincial Governments to embark upon a scale of expenditure which, it was feared, would be impossible to maintain. In order, therefore, to guard against the results of too sanguine expectations, the Government of India decided in 1884 to fix a minimum balance for each province. The balances of the different Governments thus fixed were: Bengal, Madras, Bombay, and North-Western Provinces and Oudh, £200,000 each; Punjab, £100,000; Central Provinces, £80,000; British Burma, £60,000; Assam, £50,000.

In 1885, the Finance Member, Sir Auckland Colvin, asserted that the system inaugurated by

Lord Mayo had continued to work, notwithstanding some element of risk, to the advantage of the Provincial Governments, and that friction had been reduced to a minimum. He also said that, in regard to questions relating to the amount of assistance asked for from the Government of India for provincial objects, the Provincial Governments had given evidence of the existence of a spirit of mutual concession, which was in marked contrast to the relations existing in former times between the Supreme and Provincial Governments under the centralised system of finance.

In 1886-87, the Government of India was faced with an acute financial distress owing to the Burma expedition, largely increased military expenditure, and the loss due to a continuous fall in exchange. It was found necessary, therefore, to call upon the Provincial Governments for help with a total contribution of £400,000. The old provincial contracts expired at the end of the year, and new contracts were made for five years from the first of April, 1887. As the financial difficulty continued, the Government of India took advantage of this revision to strengthen its own position by reducing the provincial share of the revenues. In a Resolution published in the Gazette the Government of India stated the principles by which it was guided in the arrangements recently concluded with the Provincial Governments. On

the occasion of introducing the Financial Statement for 1887-88, Sir Auckland Colvin drew the attention of the Legislative Council to the history of the policy of financial decentralisation in order to prove that the procedure adopted by the Government in the late revisions had been identical with the procedure laid down in past times.[1]

With regard to increase in revenue, he expressed the opinion that while the Government of India had left to the Provincial Governments the use of their share in the increase, during the contract term, of the revenues assigned, it had in specific terms, and on successive occasions, laid down and acted upon its claim to review and revise its share in the common revenues when the term of contract expired. It was compelled again, on the present occasion, to act in accordance with this last reserve; because, important though the interests of the Provincial Governments in matters of finance unquestionably were, they were second to those of the Supreme Government, upon which rested the

[1] Sir Auckland said: "I shall, in the first place, recall the fact that in 1870 it was as much the aim of the Government of India to strengthen its own finances as to improve the relations existing in financial matters between itself and Provincial Governments." He went so far as to assert that, if the Government of India had dealt with the question in any other manner, it would have made itself justly liable to the charge of introducing elements into the policy destructive of its stability, and inconsistent with the security of the finances of the Government of India, which were "the only serious guarantee for the independence of provincial finance."—*Financial Statement, 1887-88.*

sole responsibility for the maintenance of the financial credit of India. He then stated the four propositions in pursuance of which the revision of 1887 had been made and had in previous years been established in connexion with the former provincial contracts. These were:—First, that the amount of the funds assigned to Provincial Governments need not exceed, or equal, the amount of the expenditure assigned at the time when the contracts were made, Provincial Governments being expected to provide by their own resources the difference between assigned revenue and expenditure. Second, that the growth of provincial expenditure during the term of a contract must be met from the growth of provincial revenue, except in cases where considerable expenditure was undertaken by Provincial Governments to meet the wishes of the Government of India, and to carry into execution projects which were pressed upon it by that Government. Third, that the Imperial Government reserved its claim, on the expiry of a term of contract, to such a share as the circumstances of the time might make necessary in the increase of the revenues which had accrued to the province during the term of the contract, but which had been reserved to the Provincial Governments during such term. Fourth, that the power of enforcing reduction, on the occasion of a new contract, of the assignments of revenue made at the previous contract, was a condition implied in

the system of provincial contracts, and had been uniformly acted upon.[1]

Sir Auckland Colvin, placed in a situation of financial difficulty, had perhaps some valid excuse —if not justification—for making an inroad upon the finances of the provinces. It is also true that the letter of the declarations of the early promoters of the decentralisation scheme gave him an opportunity of which he did not hesitate to take full advantage. But, surely, the conclusions drawn by him from past history were not consistent with the growth of a true system of provincial finance, and it was attitude of this sort on the part of Finance Members that led to the failure of the system.

In the provincial contracts of 1887 it was arranged that each Provincial Government would receive three-fourths of the increase in stamp revenue, and one-fourth of that in excise

[1] *Finance Member's Budget Speech, 1887.*

The Finance Member stated that, in making this settlement, the Government of India had scrupulously maintained itself within the lines laid down in 1870, 1877 and 1882; and that it had exercised no powers which had not been indicated, nor claimed any concession which had been abandoned. At a time of financial difficulty, he added, the Government of India had been compelled to use its powers with more discretion than had been necessary on the previous occasions; and the assignments of revenue to the several provinces had been made on the basis of past experiences, and on an estimate of their immediate requirements, rather than on a review of the special claims of conditions or needs of each province. In this connexion, the Finance Member quoted the opinions of Lord Mayo and Sir John Strachey on the subject.

revenue, the Government of India receiving the remainder of the increase under the two heads. The expenditure under the heads of excise and stamps would be divided between the Provincial Governments and the Imperial Government in the same proportion in which the revenue was divided. In the case of the land revenue, one-fourth of the future increase would be received by each of the four larger Provincial Governments and three-fourths by the Government of India. The balances held at the credit of the Provincial Governments, which were quite substantial in some cases, were not interfered with.

The results of this revision of the provincial contracts were as set out below:

In regard to land revenue, the provincial proportion of the increased assigned revenue was ·32 in Bengal, ·25 in the North-Western Provinces, ·41 in the Punjab, ·29 in Madras, ·60 in Bombay, ·49 in the Central Provinces, ·33 in Burma, and ·63 in Assam. The provincial shares in the improvement under stamp and excise were: Bengal, £171,550; North-Western Provinces, £130,150; Punjab, £23,000; Madras, £142,550; Bombay, £198, 550; Central Provinces, £45,500; Burma, £9,200; Assam, £21,300.[1] Of the total increase of revenue, roughly speaking, a little less than two-thirds

[1] *Financial Statement, 1887-88.*

went to the Imperial Government and the rest to the Provincial Governments.

The total amount of revenue resumed by the Government of India at the time of this revision was an annual sum of £640,100. The resources of the different provinces were reduced by the following amounts: Bengal, £103,600; North-Western Provinces, £100,000; Madras, £174,400; Bombay, £221,900; Central Provinces, £15,600; Assam, £24,600.[1] No resumption was made in the Punjab or Lower Burma. There were good reasons for this indulgent treatment of these two provinces.

[1] A supplementary contract was made with the Central Provinces for the conduct of its settlement operations. The grant was £40,000 for the first year and averaged £30,000.—*Vide Financial Statement, 1887-88.*

It may be mentioned that the provincial contracts did not, in every case, cover the same ground. Though the essential parts of the system were the same in all the provinces, there were certain special arrangements which might be regarded as additions to the original scheme. The most important of these special arrangements was the contract in respect of irrigation. The revenue and expenditure under this head were made over to the Governments of Bengal, the North-Western Provinces, and Madras with grants equal to the net burden. No contract was, however, made with Bombay in respect of irrigation. There were also three small items which might be regarded as subsidiary contracts. The first related to certain salt and customs establishments, the responsibility for which was transferred in Bengal and Madras, and to a limited extent in Bombay. The second was an arrangement made with reference to certain items of expenditure classed as political, which amounted to $3\frac{3}{4}$ lakhs in Bombay, but were very small in Bengal, the North-Western Provinces, and Madras. The last was a special arrangement made with Bengal in respect of the Eastern Bengal Railway. *Vide* J. Westland's *Note on Provincial Financial Arrangements, 1888.*

In the former province, the revenues had not made the same advance as in the other provinces, and the Government of India had found it necessary during the term of the previous contract to concede an increase of about £30,000 to the original assignment. In Burma, the contract of 1882 had not worked successfully as the expenditure had surpassed the limits of the revenue, and, during the three or four years previous to the revision, the Government of India had been obliged to supplement the provincial resources by grants of four or five lakhs of rupees a year.[1] The net gain to the Government of India in the first year of the new contracts was £490,000.

One of the noteworthy features of the arrangements was the small size of the provincial balances. The following balances remained to the credit of the different Provincial Governments on April 1, 1887: Bengal, *nil*; the North-Western Provinces, £130,400; Punjab, £34,700; Madras, £187,800; Bombay, £296,800; Central Provinces, £82,600; Burma, *nil*; Assam, £10,400.

An important matter relating to the arrangements of 1887 deserves notice. In a Resolution dated the 28th January, it was laid down that

[1] No new contract was made with Burma in the same sense as with the other provinces, its somewhat abnormal condition rendering it inadvisable to conclude at the time financial arrangements which would necessarily affect the administration for the following five years. It was hoped that the terms of a new contract would be concluded during the year 1888-89.

sums not provided in the provincial estimates of a given year were not to be expended out of the balances during that year. To this exception was taken by the Provincial Governments on the ground that the balances belonged to them and that there seemed no reason why they should not have power to spend them when they wished to do so. In reply, the Finance Member pointed out that, as the Government of India was responsible for all resource operations, it was necessary for it to impose the condition that adequate notice must be given before any portion of its balances was demanded by any Provincial Government.[1]

It should be noted that this revision had been preceded by inquiries of a searching character

[1] Sir Auckland Colvin said: "The balances, it is true, are the balances of the Local Governments. But they are balances standing at their credit upon an account in which the payments have to be carefully and with great labour adjusted to the incomings. The Government of India relieves the Local Governments of all responsibility for resource operations; of all concern in finding, at the time and place where they are wanted, the actual funds for carrying on their expenditure; and it is necessary to impose upon them the condition that notice shall be given before it is demanded that these balances be produced in hard cash at any given place. At the commencement of each financial year, the Government of India ascertains the requirements of each Province as entered in its budget; it reckons up its own requirements for the coming year, and it makes provision for ways and means accordingly. But if a Local Government has neglected to enter in its estimates considerable sums which, during the currency of the year, it finds that it desires to expend, it is obvious that the calculations of the Government of India, which were made on the data furnished to it in the estimates, may be very seriously vitiated, and its ways and means may be subjected to no little disarrangement." *Speech in the Governor-General's Council, 1887.*

made by a Finance Committee. The ability and local knowledge of the members of the Finance Committee had enabled them to make the fullest use of the opportunities furnished them, and to throw light upon the details of provincial administration, which, in the interests of efficient and economical government, were expected to be of the greatest use in future. The great advantage of such an enquiry was that, if any of the contracts proved difficult to work, it would be possible to ascertain where the weak point lay, and to dispose of it more summarily and effectively than had been found practicable under the former contracts.[1]

In spite of the adverse character of the settlements of 1887, it was found in the following year that the financial position of each one of the Provincial Governments was quite sound, and they all possessed substantial balances.[2] Their position was indeed in curious contrast with that of the Imperial Government whose finances were in a

[1] *Financial statement, 1887-88.*

[2] The finances of the four largest provinces in 1887-88 were as follows:—

	Opening balance Rs. (000 omitted).	Receipts Rs. (000 omitted).	Expenditure Rs. (000 omitted).	Closing Balance Rs. (000 omitted).
Bengal	19,99	4,81,09	4,67,73	33,35
North-Western Provinces	48,38	2,99,93	3,04,84	38,47
Madras	43,37	2,70,11	2,60,22	53,26
Bombay	54,90	3,79,00	3,81,46	52,44

deplorable condition owing to the Burmese War and the fall in the value of the rupee.[1]

The Secretary of State, in sanctioning the additional taxation necessitated by the financial difficulty of the Government of India in 1888, examined and reviewed the financial relations between the Imperial and Provincial Governments. He pointed out the inequality of the then existing arrangements which secured freedom from financial difficulties to Provincial Governments, while the Supreme Government might be passing through a phase of acute distress. He also requested the Government of India to consider the propriety of arrangements which protected Provincial Governments from sharing in the financial responsibilities of the Empire, and for contributing to their relief.

Accordingly, proposals were made in October, 1888 for an alteration in the financial relations between the Supreme and Local Governments,

[1] In 1888, the Finance Member pointed out that there was not one of the Provincial Governments which had not revenue enough for its then existing scale of expenditure, or rather, which had not incurred any permanent obligations as to expenditure beyond the scale of its revenue. Moreover, all the chief provinces had balances which they were seeking the means of profitably expending. The position of the Imperial Government was entirely the reverse of this. But, though the Imperial Government might for the moment envy the Provincial Governments in their possession of assured revenues and high balances, he said that it should be borne in mind that these ample revenues had been created by the provincial system, and would not have existed but for the assignment to the Provincial Governments of their share in the improvement of them.—*Vide Speech in the Legislative Council, 1888.*

which would virtually have the effect of terminating the provincial contracts of 1887-88. These proposals met with much opposition, and it was decided to reserve for future determination a decision on the questions involved. It was, however, settled as a temporary expedient that each Provincial Government, except the Punjab, should make a contribution in aid of imperial revenues in 1889-90. The total amount of these contributions was Rs. 74,00,000.[1]

In the course of the year, however, the financial position of the Government of India improved to some extent, and it became unnecessary to revise the financial relations between the Government of India and the Provincial Governments. In 1890, it was strongly urged in the Legislative Council of the Governor-General by official as well as non-official representatives of the various provinces that the contributions made by the Provincial Governments in 1888-89 should be returned to them. Sir Steuart Bayley, then Lieutenant-Governor of Bengal, joined in the appeal and described the contributions as "enforced benevolences." He added that the Bengal contract had not proved a profitable one, and that the

[1] The contributions made by the different Governments were as follows : North-Western Provinces, Rs. 20,00,000 ; Madras, Rs. 17,50,000 ; Bombay, Rs. 17,50,000 ; Bengal, Rs. 10,00,000 ; Punjab, Rs. 5,00,000 ; Central Provinces, Rs. 3,00,000 ; Assam, Rs. 1,00,000 ; total Rs. 74,00,000.—*Vide Financial Statement, 1889-90.*

province had "extreme difficulties to contend with."[1]

In 1892, fresh contracts were made with the provinces. At this time it was found that the total provincial revenue had increased during the previous five years by Rs. 2,04,27,000. Out of this sum the Government of India decided to resume Rs. 46,63,000, or slightly less than one-fourth of the whole amount. The Provincial Governments strongly protested against this decision. The Government of India admitted that it would have been desirable, if possible, to allow the provinces to retain the whole of this increase, as all of them had many needs on which money could be usefully spent. But it pointed out that, as the financial position of the Central Government was very unsatisfactory, this could not be done without imposing additional taxation. The Government of India justified its action on the ground that it was a lesser evil to restrict to some extent the progress of useful provincial expenditure than to impose additional taxation.

In 1894, the Government of India again called upon the Provincial Governments for contributions

[1] *Proceedings of the Legislative Council of the Governor-General*, 1890. Mr. (afterwards Sir) Griffith Evans, a leading member of the Calcutta bar, in describing the straitened finances of Bengal, said : " I can only vouch for the outward and visible signs of poverty, ruthless economy, and starving of all departments ; all the symptoms of a painful attempt to make both ends meet. How near they have met I do not know."

to its aid, in order to enable it to cope with the financial difficulty. This step practically implied the stoppage for the moment at least of all administrative improvement in the provinces. It was also calculated to dishearten the Provincial Governments, by making them surrender all the fruits of careful administration to fill the yawning gulf of the Government of India's deficit. But in addressing its demand to the provinces the Government of India said : "The imperious necessity for imposing new taxation obliges the Government of India first to exhaust all available methods of increasing their resources ; and this necessity is the only justification they can put forward for so soon making a practical revision of contracts made only two years ago, and calling in balances which the Local Governments might legitimately claim as pledged to them for the purpose of administrative improvement."[1]

The improvement in its financial position in the following year made it possible for the Government of India to restore to the provinces the contribution of Rs. 40,50,000 made by them in 1894. There were, indeed, certain special circumstances in the provinces which made it necessary and advisable for the Government of India to make the repayments.

The usual quinquennial investigations were made in the course of the year 1896-97 for the

[1] *Financial Statement, 1894-95.*

purpose of a fresh settlement. The first step in these settlements was to enquire as to what was to be accepted as the proper amount of expenditure in the provinces for which an assignment of revenue was to be made. As a result of this enquiry it was found that the increases which had taken place in provincial expenditure had been moderate. An examination of the revenue side of the provincial accounts showed the following results : The Central Provinces had been hard hit by two or three bad seasons, and had been disappointed in the increase of revenue which they might reasonably have expected. The Government of India, therefore, found it necessary to enhance its assignment by Rs. 29,200 a year. Assam had shown a fairly progressive revenue, but it was a poor province with many wants. It was, therefore, left with its previous assignment. Burma was a young and rapidly progressive province, and it was decided to treat it with leniency. It was also thought desirable to deprovincialise the railways in this province and to unite Upper with Lower Burma under a Lieutenant-Governor. The Punjab was a politically important province, and it had shown only a moderate expansion of revenue. It was found desirable to concede to it an allowance about equal to the expenditure imposed on it by exhange compensation, and also a grant in recoupment of its balances exhausted by the famine. On this occasion, irrigation

revenue, as well as expenditure, was provincialised in Bengal, the North-Western Provinces, and Madras.

The darker side of the system of provincial contracts had by this time become apparent to all. The Provincial Governments bitterly complained of the procedure adopted on the occasion of each fresh settlement. Sir Alexander Mackenzie, then Lieutenant-Governor of Bengal, observed as follows in 1896 in the course of the debate on the budget: "The provincial sheep is summarily thrown on its back, close clipped and shorn of its wool and turned out to shiver till its fleece grows again. The normal history of a provincial contract is this: two years of screwing and saving and postponement of work; two years of resumed energy on a normal scale, and one year of dissipation of balances in the fear that, if not spent, they will be annexed by the Supreme Government at the time of revision."

Nor did the general public fail to condemn the system in unequivocal terms. The Indian National Congress which met in Calcutta in 1896 passed a resolution expressing the opinion that the allotments made to the Provincial Governments were inadequate, and that the time had arrived when a further step should be taken in the matter of financial decentralisation, by leaving the responsibility for the financial administration of the different provinces to the Provincial Governments, the

Supreme Government receiving from each Provincial Government only a fixed contribution levied in accordance with some definite and equitable principle.

A strong sense of disapproval of the system was also expressed in the Legislative Councils. It was said that provincial contracts did not conduce to economy in financial administration or the material progress of the country. It was argued that the apportionment of the revenue was unfair as between the imperial and provincial needs, while the distribution of provincial resources was unequal as between one province and another. Further, it was pointed out that short-term settlements were not calculated to inspire a sense of security or certainty, and the periodical revisions were a fruitful source of irritation and discontent as the benefit of provincial economy and careful management went mainly to the Central Government. Mr. Sayani, a non-official member of the Governor-General's Council, observed that, if the system of provincial finance was at all to realise the high expectations of its authors, it would require "a thorough revision."[1]

[1] Mr. Sayani added: "In fact, our present arrangements do not tend materially to promote provincial progress as was originally intended, but, on the other hand, by dissociating power from responsibility and leaving the provincial administrations with uncertain and inadequate resources to meet the requirements of their respective provinces, have simply served to bring to the Imperial Government administrative relief and a freedom from financial anxiety in respect of

Another non-official member of the Council, Mr. Ananda Charlu, entreated the Finance Member to earn the lasting gratitude of India by a true system of decentralisation, drawing a definite line between the spheres of the Central and Provincial Governments in regard to both revenue and expenditure.

The Lieutenant-Governor of Bengal also expressed his dissatisfaction with the existing arrangements. Sir David Barbour, a former Finance Member of India, in the course of his evidence before the Welby Commission, stated that the existing practice was not in accordance with the original intention of the framers of the policy of decentralisation. He said: "I must say that, when the provincial system was started, I do not think it was intended that the Provincial Government should have a portion of their resources taken away periodically...If you take all the surplus, you to a certain extent remove all the inducements to the Provincial Governments to economise. It is a weakness: the periodical revision may be necessary under present conditions, but it diminishes the value of the system. Take the province of Bengal, with a population of between 70 and 80 millions of people: well, that province is big enough to have an independent financial system." He then went

internal progress which conditions of the case scarcely justify, and tend moreover to a diversion of its energy and funds to less legitimate objects."

on to explain that, owing to financial exigencies, the Government of India took at each revision, not only its own share of the increase in the divided revenues, but also a portion of the increase that had accrued to the Provincial Governments. Sir David Barbour concluded with the significant words: "I would rather see the Central Government embarrassed than the Provincial Governments starved."

Dissatisfaction with the system of provincial contracts continued to be voiced both in and outside the legislatures. Complaints became louder and more persistent as the termination of the contracts of 1897 came nearer and nearer. Criticism was particularly directed against quinquennial revisions. The system was condemned by enlightened public opinion; the Provincial Governments were dissatisfied with it; even the Government of India could hardly claim that it was satisfactory. The main drawbacks of the system were as follows: In the first place, the apportionment of revenues to the different provinces was never made on any definite or logical principle. Secondly, periodical revisions interfered with the continuity of provincial finance, and each revision involved a protracted and sometimes controversial discussion with the Provincial Governments. Thirdly, the system tended to encourage extravagance rather than economy. In theory, each Provincial Government was supposed

to be free to enjoy the fruits of economy or of the nursing of its revenues. But, in practice, its term of enjoyment was limited to five years, or more correctly, to the last two or three years of the period of settlement, for during the earlier years it had usually very little margin to draw upon. It was, therefore, under constant temptation to spend its money not on carefully matured schemes of improvement but on such as could be carried through before the close of the settlement, so as to leave as small a balance as possible for resumption. The system of five-yearly budgets was thus the root of much evil.[1]

The settlements of 1897 were due to expire on the 31st March, 1902. But no revision was made at the time except in the case of Burma. The reason was that, owing to plague and famine, the conditions in many parts of the country were so abnormal that it was found impossible to arrive at any accurate estimate of resources and requirements which would permit of an equitable settlement being worked out. Burma had not been affected by these calamities, and her position was one of steadily increasing prosperity. A revision of the settlement was thus made with the province, and on this occasion the Government of India resumed an annual sum of £280,000.

The discussion which took place in the Governor-General's Legislative Council in 1902 is

[1] *Vide Financial Secretary's Memorandum, 1904.*

interesting. The representatives, official as well as non-official, of almost all the provinces urged their special claims. Mr. Hardy, the official member for the United Provinces, said: "It will not be denied that the United Provinces cannot carry on the administration on the present contractual terms." Mr. Sri Ram, a non-official representative of the province, joined in this plea for better treatment being conceded to his province. He took strong exception to the view which had been expressed by Sir James Westland some time ago to the effect that the first claim on the provincial revenues was the claim of the Imperial Government. The Lieutenant-Governor of Bengal also condemned the policy of the Government of India.

The Finance Member, Sir Edward Law, gave an outline of the policy which had been pursued in the past in the matter of provincial settlements. He then observed: "I have given my great attention to the details of this question, and I find it most complicated and difficult. Nearly every province in India is convinced that the share of revenues assigned for its needs is totally inadequate, and, moreover, many provinces consider that they are sacrificed for the benefit of more fortunate rivals. Some are very loud in their complaints, others accept quietly what they nevertheless consider to be an unjust fate. All I can now say is that, whilst recognising that

backward or abnormally distressed provinces have special claims for assistance which can only be given at the cost of more prosperous neighbours, the Government of India are sincerely anxious to remove all just cause of complaint, and, as far as resources may permit, to provide sufficiently for a reasonable and healthy growth of provincial requirements."[1]

In reply to the criticism of Mr. Sri Ram, the Finance Member said: "My friend quotes, with apparent disapproval, a statement made by Sir James Westland, to the effect that the first claim on provincial revenues is the claim of the Imperial Government. I feel bound to state that the principle thus enunciated is one which I fully accept, and which I feel confident will be fully accepted by all my successors. Has my hon'ble friend fully considered what is the nature of the revenues which he terms provincial? I would point out to him that the revenues, the application of which we discuss in considering provincial settlements, are speaking generally, in no sense, provincial. They are imperial revenues, collected, for convenience, by provincial administrators, who deduct the cost of their collection, whilst benefiting provincially by the expenditure involved in the collection. It seems to me self-evident that the reasonable demands of the Central Government on the

[1] *Proceedings of the Governor-General's Council, 1902.*

proper working of which the whole administrative machine depends, must be held to be a primary lien on all revenues collected, except such as are specially raised, in addition to ordinary taxes, for the satisfaction of purely local needs."[1]

These words seemed to embody a narrow interpretation of the principles of provincial finance. What was needed at the time was an expansion—not a contraction—of the existing system. It might also appear from a cursory view of Sir Edward Law's remarks that not only was he opposed to the fundamental basis of provincial finance but that he intended to pursue a retrograde policy in regard to the matter. But this was not really so, as we shall see later.

Lord Curzon gave a forecast of a further development of provincial finance in 1903 when he observed: "Though they have their obvious merits, they have not been unattended with friction and with drawbacks in operation. My colleagues and I would greatly like, if we can, to invest these agreements between the Supreme and Local Governments with a more permanent character that would stimulate the energies of Local Governments and give them a greater interest in economy and good administration, while retaining for the Imperial Government the necessary measure of ultimate control."[2]

[1] *Proceedings of the Governor-General's Council, 1902.*
[2] *Proceedings of the Governor-General's Council, 1903.*

CHAPTER V

SEMI-PERMANENT AND PERMANENT CONTRACTS

In 1904, an important step was taken to remedy some of the defects of the system of provincial contracts. The object of the new arrangements was to give greater permanence to the settlements, so that Provincial Governments might be able to form plans involving expenditure, with greater certainty as to the future means of providing for their execution, and at the same time feel a more abiding interest in the growth of assigned revenues. The Government of India, however, made it clear that it did not undertake any absolute obligation to maintain at all times a definite proportion between the share of increase of revenues assigned to provinces and that which it was necessary to retain to meet the growth of imperial expenditure. It reserved the right to make either temporary or more permanent reductions from provincial revenues, if the exigencies of the State required such measures. On the question of apportioning shares of revenue to different provinces, the Government of India held that a larger proportionate assignment was required in the more backward provinces than in those

which were older established and more highly developed.

The main features of the new arrangements were the following: First, it was decided to give the Provincial Governments a permanent, instead of a merely temporary, interest in the revenue and expenditure under their control. Secondly, it was arranged that the assignments to the Provincial Governments would include a slightly smaller share of growing revenues. Thirdly, this share was so calculated that each province separately, and all the provinces taken together, should be placed in possession of an amount of growing revenues which bore approximately the same proportion to the provincial expenditure as the imperial share of growing revenues bore to imperial expenditure. With some small exceptions, the actual heads of revenue which were either imperial, provincial, or divided, were left unchanged; but the provincial shares of the divided heads were altered in accordance with the principle stated above. When any head of revenue was divided between imperial and provincial, the corresponding head of expenditure was also ordinarily divided in the same proportion.

In applying these principles to the actual figures, it was found that the aggregate provincial expenditure represented rather less than one-fourth of the whole, while the imperial expenditure, which included the army and the home charges,

was somewhat in excess of three-fourths. These proportions were accordingly taken as the basis of the division of revenues between the Imperial and Provincial Governments. But numerous adjustments were found necessary—first, to make allowance for the heads of revenue which were wholly imperial or wholly provincial, as the case might be; secondly, to allow for a larger assignment to the more backward provinces than to those which were more advanced; and thirdly, to permit of provision being made for various administrative reforms and works of improvement which it was desired to undertake. Subject to these adjustments, it was decided that the divided heads of revenue, and of the corresponding heads of expenditure, should be shared as follows:—(1) In Bengal, the United Provinces, Bombay and Madras, three-fourths imperial and one-fourth provincial; (2) in the Punjab and Burma, five-eighths imperial and three-eighths provincial; and (3) in the Central Provinces and Assam, half imperial and half provincial.

It was intended that the settlements thus made should be permanent, in the sense that they should not be subject to revision at the end of fixed periods. The Government of India reserved to itself, as the final authority in India responsible for the finances and the administration of the country, the power to revise the settlement of any or all provinces at any time necessity might

demand it. It was, however, made clear that the Government of India intended only to exercise this power when the variations from the initial relative standards of revenue and expenditure in any province were, over a substantial term of years, so great as to result in unfairness either to the provinces or to the Government of India. The only other contingency in which a variation was likely to be made would arise when the Government of India was confronted with the alternative of either imposing additional taxation or of seeking assistance from the provinces. The scheme was applied at the outset to four provinces, namely, Bengal, Madras, Assam, and the United Provinces.

The arrangements which were made with these provinces were as follows: For Bengal, the provincial share of revenue and expenditure was taken at one-half under stamps, and at seven-sixteenths under excise, while registration receipts and charges were made wholly provincial. The expenditure recorded under land revenue, which really represented the cost of the ordinary district administration, was also made wholly provincial. An addition of 4 lakhs was made to the fixed assignments to enable the Provincial Government to improve the pay of ministerial establishments. In Madras, the provincial share of stamp revenue and expenditure was raised to one-half. The revenue and

expenditure under registration, and expenditure under land revenue were made wholly provincial. Special provision was made in the form of a lump non-recurring grant of 20 lakhs for surveys and settlement. Besides, grants of Rs. 75,000 and Rs. 50,000 a year were made for the relief of certain local bodies, and for agricultural experiments. The fixed assignment was placed at a specially high figure. The Government of India also undertook to provide for the cost of re-organising the district administration. For the United Provinces, the provincial share of stamp revenue and expenditure, and of the expenditure under land revenue was raised to one-half. Irrigation revenue was made wholly provincial, subject to a guarantee from the Government of India that the net receipts should not fall below 40 lakhs a year. Special grants of 2½ lakhs and 1½ lakhs per annum respectively were made to enable the Provincial Government to relieve Municipalities from the charges for municipal police, and to reform the system of District Board finance.

The net result of the new settlements in these four provinces was an increase of the imperial contribution to provincial funds of Rs. 23,89,000 per annum, which was distributed as follows: Bengal, Rs. 5,00,000 *less*; Madras, Rs. 16,56,000 *more*; United Provinces, Rs. 8,25,000 *more*; Assam, Rs. 4,08,000 *more*. The shares of growing revenue and the fixed assignments from

imperial to provincial funds stood thus in the different provinces: Bengal, Rs. 4,98,87,000; United Provinces, Rs. 3,66,64,000; Madras, Rs. 3,50,48,000; Assam, Rs. 72,07,000.[1]

The effect of the alteration in the shares is worth noticing. A comparison of the shares of the average annual increments of revenue (calculated on the basis of the figures for the years 1892-93 to 1902-03), which the Provincial Governments would have received if the terms of the old settlements had remained unchanged, with the shares which they were to receive under the new settlements may be shown in tabular form thus:

(In thousands of Rupees)

	Under the Old Settlements	Under the New Settlements
Madras	5,60	4,89
Bengal	9,00	7,33
United Provinces	3,33	3,91
Assam	1,50	1,24

In other words, it was decided that, out of the annual increment of the revenues of the four

[1] The details were as follows:

(In thousands of Rupees)

	Madras	Bengal	United Provinces	Assam
Growing Revenues	2,90,82	4,49,84	3,62,64	60,07
Fixed Assignments	59,66	49,03	4,00	12,00
Total	3,50,48	4,98,87	3,66,64	72,07

The provincialisation of the whole of the irrigation revenue in the United Provinces, and the assignment of half shares of the principal heads of revenue in Assam, accounted for the large proportion which the growing revenues bore to the total in those provinces.

provinces taken together, the Imperial Government would receive Rs. 2,06,000 more than it had hitherto done. On the other hand, owing to the division of expenditure under the heads corresponding to the principal heads of revenue, the Government of India would bear Rs. 36,000 of the provincial increment of expenditure. The net effect of the alterations in the shares was that the Imperial Government received an additional net increment of revenue of Rs. 1,70,000.

The new arrangement was thus more beneficial to the Central Government than to the provinces. Bengal, Madras, and Assam were placed in a worse position than under the previous settlement, while the position of the United Provinces was improved to some extent. But in order that the Provincial Governments might start the new settlements under favourable conditions, the Government of India sanctioned the following initial grants to the provinces; namely, Bengal, 50 lakhs; Madras, 50 lakhs, United Provinces, 30 lakhs; Assam, 20 lakhs.[1] Certain other grants were also made to the provinces for special purposes.

On the occasion of the budget debate in the Indian Legislative Council, Lord Curzon observed with regard to the old system which had existed for a quarter of a century: "It was better than the system that preceded it, but it admitted of much improvement. It was not an economical

[1] *Vide Financial Secretary's Memorandum, 1904.*

plan, because it encouraged extravagance in the concluding years of each term, and it was not a satisfactory plan, because it led to a rather unseemly squabble with the Supreme Government at the end. The better method was clearly to give to Local Governments a permanent instead of a temporary interest in the revenue and expenditure under their control, subject to certain broad principles in fixing the provincial assignments. This we have succeeded in doing in the cases of Madras, Bengal, the United Provinces, and Assam, and have thereby laid the foundations of a financial autonomy that, I hope, will steadily develop and will enable the Local Governments in the future to undertake enterprises from which they are now debarred." [1]

"These new settlements," he added, "constitute, in my view, the most important step in the nature of decentralisation that has been adopted

[1] *Vide Proceedings of the Governor-General's Legislative Council, 1904.*

"I mention the matter here," added Lord Curzon, "because of its intrinsic importance and because I agree with the Lieutenant-Governor in thinking that it furnishes a conclusive answer to those who are accusing the Government of India of undue centralisation. I would point out that efficiency of administrative control is not centralisation, though it is often mistaken for it. Centralisation is the absorption by a central body of powers and privileges hitherto enjoyed, or capable, if created, of being exercised, by subordinate bodies. I acknowledge no such tendency. We have kept Local Governments up to the mark, because I do not believe in lax or sluggish control, or in the abdication of powers which have been provided for special objects."

for many years, and will, I hope, be the forerunner of others in the future." These were significant words, but it was long before any real steps were taken to translate them into action.

In the meantime, the question of devolution of further powers on the Provincial Governments had come to the fore. Sir Steyning Edgerly observed in 1907 that the danger of centralised administration was becoming very serious, and he suggested the appointment of a strong committee to work out a scheme of devolution of financial and administrative control. In the same year, a Royal Commission[1] was appointed with instructions to report whether, by measures of decentralisation or otherwise, the financial and administrative relations then existing between the Supreme Government and the Provincial Governments could "be simplified and improved, and the system of government better adapted both to meet the requirements and promote the welfare of the different provinces."

Various criticisms and suggestions were placed before the Commission in regard to the financial positions of the provinces under the quasi-permanent settlements. The first point for consideration

[1] The composition of the Commission was as follows: Sir Henry Primrose, Chairman, Sir Frederic Lely, Sir Steyning Edgerly, Mr. R. C. Dutt, Mr. (afterwards Sir) William Meyer, and Mr. W. L. Hichens. Sir Henry Primrose subsequently resigned, and Mr. C. E. H. Hobhouse, then Under Secretary of State for India, was appointed Chairman of the Commission.

was whether a more definite separation might be made between imperial and provincial finance. It was suggested that the divided heads should become wholly provincial, the Government of India being reimbursed by a contribution from each province on the analogy of the *matrikular beitrage* of the German Empire.[1] But the Commissioners rejected the proposal on various grounds, the most important of which was that any such change would convert the share which the Government of India took of the revenue raised in the provinces into the character of a tribute paid by the Provincial Governments to an outside administrative authority. The Commission did not, however, ignore the fact that, in some provinces, fixed assignments from the

[1] This might take the shape of (*a*) a fixed sum revisable every few years; (*b*) a lump percentage on the provincial revenues; or (*c*) a fluctuating contribution imposed by the Government of India and calculated upon the population or wealth, or perhaps even the revenues, of the different provinces. The Commissioners considered suggestion (*a*) impracticable, for periodical revisions would provoke recurring controversies with the provinces. In regard to suggestion (*b*), they pointed out the practical difficulty of fixing the percentage for the different provinces and the considerable degree of controversy it was likely to lead to. Suggestion (*c*) was dismissed on the ground that a subsidy on a population basis would be unfair to poor and undeveloped provinces, while there was no method of assessing the comparative wealth of each province which would not cause infinite trouble and give rise to infinite criticism. A fluctuating contribution based on provincial revenues would, of course, be feasible, but it would introduce such an element of uncertainty into the provincial finances that the position of these would be changed for the worse.

Government of India had tended to increase disproportionately and to put the provinces in a worse position, *pro tanto*, than if it had had a corresponding amount of growing revenues to meet the inevitably growing expenditure. The grievance was a valid one, but the Commissioners thought that this difficulty could be satisfactorily met by occasional revisions of settlement which would give such a province a larger share of growing revenue. In regard to the proposal to make some of the existing divided heads wholly provincial and others wholly imperial, the Commissioners urged the following objections: First, the Provincial Governments benefited by broadening the basis of their revenues. Secondly, the arrangements by which the Government shared in the receipts and expenditure of some of the most important provincial heads of administration made them more interested in, and identified with, local developments. Thirdly, as a matter of general policy, it seemed undesirable to encourage the idea that the Government of India was chiefly concerned with relatively unpopular services, such as salt, military expenditure, and home charges. The conclusion, therefore, at which the Commission arrived was that it would be undesirable to make any sudden and violent change in the system of divided heads; but they favoured the conversion of unduly large fixed assignments into shares of growing revenue. Moreover, they

suggested that, as the financial position of the Government of India permitted, it would be necessary to enlarge the resources of Provincial Governments so as to enable them to provide for the expansion and improvement of the subjects under their control.

These considerations applied to the existing conditions of administration. But the Commissioners recognised that the grant to the Provincial Legislative Councils of material control over provincial finance might make it necessary to do away, as far as possible, with divided heads, and to place some heads entirely within the purview of the Provincial Governments and others within that of the Imperial Government. Objection was taken by some of the Provincial Governments as well as by several witnesses who appeared before the Commission to the system of grants made by the Government of India to the provinces for special purposes. The main ground of attack was that the "doles"—as these grants had come to be termed—became an instrument for increasing the control of the Government of India over the Provincial Governments.[1] While holding the view that there were defects in the system, the Commissioners considered any material change undesirable. But they suggested that the policy

[1] Another ground of objection was that it involved considerable labour in the preparation of special accounts called for by the Central Government to show how the money granted by them had been spent.

of special grants should be maintained subject to two conditions, namely, (*i*) that such grants did not involve any greater administrative control by the Government of India over the Provincial Governments and particular departments concerned than what already existed, and (*ii*) the views of the Provincial Governments were fully considered before any decision was taken as to the relative urgency of the subjects upon which grants were to be expended.

It was urged before the Commission that Provincial Governments should be allowed to deal finally with their own budgets, or at any rate, that they should have this power in respect of the purely provincial heads. The Commissioners rejected these proposals, and recommended that the provincial budget estimates should continue to be controlled by the Government of India. But they urged that meticulous alterations in provincial figures by the Government of India should be avoided. They further suggested that the grant, when made, to Provincial Legislatures of an effective control over provincial finance would render it desirable to give Provincial Governments more power over their budgets and more distinct sources of revenue.

The Commissioners disapproved of the suggestion that the Provincial Governments should have power to draw on their balances without reference to the Government of India. They recommended

that Provincial Governments should not have power to impose additional taxation, or make any fundamental change in the revenue system, without the previous sanction of the Government of India.[1] They further suggested the maintenance of the following rules, namely, that (*a*) a Provincial Government must not undertake any new service or duty without the sanction of the Government of India, (*b*) the codes and standing orders of the Government of India must be followed, (*c*) Provincial Governments must not alter the form or procedure of the public accounts, and (*d*) they must not make separate investments of public moneys.

A number of witnesses who appeared before the Commission advocated the giving of power to Provincial Governments to borrow in the open market. The arguments put forward in favour of the proposal were (*i*) that it would tap fresh local markets; (*ii*) that it would enable Provincial

[1] The Commissioners urged that the Provincial Governments had not, as yet, a sufficiently separate fiscal sphere to render such a policy desirable, and the probable tendency would be to cast fresh burdens upon the land, which already bore imperial and local taxation. Further, the Provincial Governments lacked that responsibility to the tax-payers and their representatives which acted as a check upon increased taxation in other countries. But they suggested that, when a larger degree of separation would be effected between central and provincial finance, following upon a more effective control over the provincial finances by the Legislative Councils, it would become practicable and probably necessary to invest Provincial Governments with greater powers in this respect.

Governments to raise money for important projects when the Government could not assist them ; (*iii*) that while the Government of India loans were usually confined to productive purposes, it might be also desirable to borrow for purposes which were financially unremunerative, but were of administrative importance. The Commission advanced the following arguments against the proposal: (*i*) it was very doubtful whether the Provincial Governments would be able to attract fresh capital in India and if they failed to do this, their borrowings would disturb the Government of India loans ; (*ii*) the Provincial Governments had no resources on the security of which they could borrow, and a guarantee from the Government of India would be needed, but, even with such a guarantee, the Provincial Governments would have to pay more for their loans than the Government of India; (*iii*) Provincial Governments would generally borrow for financially unproductive purposes, and this would add to the dead-weight of debt. After considering the two aspects of the question, the Commissioners held that Provincial Governments should not be allowed to borrow in the open market.

Thus we find that the Decentralisation Commission were generally satisfied with the financial relations then subsisting between the Government of India and the Provincial Governments. They did not, therefore, make any proposals involving

far-reaching effects. Two of their recommendations, however, were important from the point of view of the development of provincial finance, namely, first, that when fixed assignments in any province had become unduly large, they should be converted as circumstances would permit, into shares of growing revenue ; and second, that when the revenues of Provincial Governments required an expansion, this might be provided by gradually provincialising certain heads of revenue which were at the time divided.[1]

During the year 1905,[2] settlements of a quasi-permanent character were concluded with two more provinces, namely, the Punjab and Bombay. The principles followed were generally similar to those adopted in the settlements with the four provinces dealt with during the previous year, but the opportunity was taken to extend the interest

[1] The other suggestions were of a minor character. These were (*i*) that in respect of services for which payment was made by them, wholly or in part, Provincial Governments should receive the powers lately granted to the Government of India in regard to the creation of appointments and alteration in their emoluments, grant of allowances, deputation and temporary appointments, and addition to establishments up to a limit of Rs. 50,000 ; (*ii*) that the restrictions on the powers of the Provincial Governments in respect of the abolition of posts or reduction in their emoluments, etc., should be done away with, in the case of provincial and subordinate services; (*iii*) that rules for the recruitment of provincial services should not require the sanction of the Government of India.

[2] In 1905, grants were also made to the Provincial Governments for police reform, primary education, the development of agricultural research, and aid to the District and Local Boards.

of the Provincial Governments to the important head of irrigation, which had hitherto been almost wholly imperial. In view of the very large and remunerative projects of irrigation which had been and were being carried out in the Punjab, it was of special importance that the Provincial Government should have a direct financial interest in their efficient management ; and this applied also to a less extent to Bombay. In these two provinces, the settlement of 1897 had been a failure, mainly in consequence of the effects of the famine and plague from which both of them had suffered severely ; and for the previous few years their finances had been in constant deficit, necessitating large annual grants from imperial revenues to preserve a nominal equilibrium. To put an end to this state of things, it was necessary to assign to these Provincial Governments a considerably larger share of the revenues of their respective provinces than they had received in 1897. Their assignments were, therefore, increased by Rs. 36,92,000 per annum in the case of Bombay, and by Rs. 16,51,000 per annum in the case of the Punjab. Moreover, the provincial shares of the heads of revenue and expenditure divided between imperial and provincial were so adjusted that the average provincial annual increment of revenue was to be raised from Rs. 6,30,000 to Rs. 8,55,000 in the former province, and from Rs. 3,08,000 to Rs. 6,78,000 in the latter. Initial grants of 50

lakhs in each case, including special grants for plague charges, were also allotted, to give the provinces a good start.

A settlement was made with the Central Provinces later in the year, and with Burma in 1907. The partition of Bengal necessitated fresh settlement with that province as well as with Eastern Bengal and Assam. Certain modifications in detail were made in the settlements with the other provinces in the course of the next few years.

Before we describe the further growth of the system of provincial finance, it will perhaps be found useful to mention the main features which the provincial settlements presented in the stage of development which they had reached at the time the Decentralisation Commission reported. In the first place, the settlements had been declared quasi-permanent. Secondly, the distribution of revenues between the Central and Provincial Governments was made, not with reference to the needs of the Central Government, but to the expenditure of the Provincial Governments. Thirdly, the method by which the revenues were distributed was that certain heads were regarded as wholly imperial, others as wholly provincial, and the rest were "divided." As, however, the division of the last-named heads could never be so adjusted as to yield to a province, when added to the revenue from the purely provincial heads, the exact sum necessary to meet provincial

charges, equilibrium was effected by means of fixed cash assignments ; a deficiency being remedied by an assignment to provincial revenues from the imperial share of the land revenue, an excess by the reverse process.[1]

In connexion with the Report of the Decentralisation Commission, the Government of India referred, for the opinion of Provincial Governments, a number of specific points affecting the financial relations of the Imperial with the Provincial Governments.[2] The replies were then taken into consideration by the Governor-General in Council. It was decided not to make any radical change in the system, because it was considered "preferable to abide by the main lines of a system which had been gradually built up to meet the needs of the country, than to look about for an untried scheme of greater abstract perfection."

But in one respect the system appeared susceptible of development, and this development seemed to the Government of India to be eminently desirable in the interests of both the Imperial and Provincial

[1] *Vide Resolution on Provincial Finance, dated the 18th May, 1912.*

[2] The particular questions on which advice was sought were :—

(*a*) Certain problems regarding the assignment of revenue to the provinces under the quasi-permanent settlements.

(*b*) The desirability of provincial taxation.

(*c*) The advisability of floating provincial loans in the open market.

(*d*) The control to be exercised over borrowing by local bodies.

(*e*) The delegation of powers of reappropriation.

Vide Resolution on Provincial Finance, dated the 18th May, 1912.

Governments. The direction in which the Government of India desired to advance was by giving greater permanency to the settlements. From the point of view of the Central Government, a measure of this kind was rendered vitally important by the existing situation of imperial finance. Simultaneously with the prospect of the loss of a considerable annual revenue from opium, the Government of India was faced by the necessity of providing large and increasing funds for the extension of education, for the improvement of sanitation, and for other kindred purposes. To ensure successful conduct of its finance in these circumstances, it was essential to remove every available element of uncertainty. It, therefore, decided to introduce as great a finality as possible into the financial relations of the Imperial and Provincial Governments. If provinces could be provided, once and for all, with settlements so framed that Provincial Governments could develop their administration from their own assigned resources, and could fairly be warned that they must not, except in cases of unusual calamity, expect assistance from imperial funds, the task before the Government of India would be greatly simplified. At the same time it was considered that, by imparting greater precision to their relations with the Provincial Governments, they would give the latter a more abiding interest in the husbanding and direction of their own resources; while a

sharper definition of the limits of provincial independence in financial matters would make it possible to allow much greater freedom of executive action within those limits.[1]

On the first of the three points referred to the Provincial Governments, the Government of India considered that a fixed assignment should be replaced by a share of growing revenue in the following circumstances, namely, (*i*) when an assignment was so large as to prevent the increment in revenue from keeping abreast of the legitimate and necessary growth of expenditure, and (*ii*) when the financial outlook of the moment justified the abandonment of the necessary amount of growing revenue in exchange for the reduction of fixed charges. Such commutation was usually to take the shape of the provincialisation of heads formerly divided. Except in this connexion, however, the Government of India was not inclined to accept the provincialisation of divided heads, which was the second point of reference. The third point of reference was the question of lump grants. While fully appreciative of the various drawbacks attaching to the system, the Government of India was in complete agreement with the Commission in the view that the total abolition of "doles" was impracticable.[2] To

[1] *Resolution on Provincial Finance, dated the 18th May, 1912.*

[2] The Governor-General in Council observed in this connexion: "A line of policy pressed upon the Government of India by the

minimise their disadvantages, however, the Government of India accepted the principles recommended by the Decentralisation Commission in this regard.

Before taking any steps to impart greater permanency to the provincial contracts, the Government of India decided to remove some of the imperfections which existed in the system. In this connexion, it discussed the complaint which had often been made that the settlements were of unequal liberality in the different provinces. The Government of India, while admitting the impossibility of devising a satisfactory test of equality of treatment, observed that the haggling of a quarter of a century had established a rough equity which could not now be replaced by theoretical considerations.[1] Taking the administrative equipment

Secretary of State, by the obvious trend of public opinion, or by the competition for efficiency among Local Governments must frequently be passed on to the provinces, and to insure its efficient prosecution, it is essential that the latter should be provided with funds additional to their ordinary resources. Such will doubtless be the case with the forward movement in education and sanitation, when special grants have to be given on conditions to be settled in correspondence with Local Governments. Again, it often happens that the Imperial Government secures a surplus which cannot suitably be employed in the reduction of taxation, and it naturally wishes to share its windfall with the provinces. In both these cases, doles are unavoidable."

Vide Resolution on Provincial Finance, dated the 18th May, 1912.

[1] "One province," remarked the Governor-General in Council, "may be behind another in its jails, or a third in its roads, and its subordinate officials may be worse paid than in a fourth ; but it probably spends more than its neighbours on police or on education."

as a whole, the Government of India found it impossible to believe that inequality in the settlements had gone far enough to starve one province in its necessities in order to load another with luxuries, They, therefore, considered it entirely unnecessary, in seeking a basis for permanency, to make any radical alterations in the existing settlements which had been evolved by the slow process of years.

But the Government of India decided to undertake a careful revision of all existing settlements, with a view to the removal of minor defects[1] and the replacement of large cash assignments by

[1] The Finance Member said: "In five out of the eight major provinces, the settlements have worked in a manner that indicates no flaws in the general lines upon which they were conceived. In Eastern Bengal and Assam, the settlement is new and almost untried ; but we have no misgivings as to its success. In one province, Burma, there has been much inconvenience due to an over-estimate of its resources, which is now being slowly rectified. In the eighth province, Bengal, a settlement which began under the most favourable auspices has had a gloomy and troubled career. In its earlier days, large balances were eaten up by hasty and imperfectly considered increases in recurring expenditure ; and when the present Lieutenant-Governor sought to apply the methods of ordinary financial caution, his economies were in a great measure defeated by the effects of high prices and the costly campaign against crime. Brief though it necessarily is, this summary indicates that the defects in our present settlements are individual and not universal ; and, indeed, the only generic fault in the system is the unwieldy size that has been attained by the fixed cash assignments in most of the provinces. To rectify this, to relieve those provinces where the financial position is now unsatisfactory, and to base the permanent settlements on a broad and stable foundation, has been the object of the changes and readjustments."

shares of growing revenue. As a result of a careful examination of the financial position of each province, it was found advisable to make certain variations in the terms of the settlements. The concessions differed to some extent from province to province, but the most important of them were as follows :—

1. (*a*) Forest revenue and expenditure were made wholly provincial in all the provinces.

(*b*) Excise revenue and expenditure were made wholly provincial in Bombay, while in the Central Provinces and the United Provinces, the provincial share of these heads was increased to three-quarters.

(*c*) Land revenue was made half provincial in the Punjab and five-eighths provincial in Burma.

(*d*) The provincial interest of the Punjab in major irrigation works (direct receipts, working expenses and interest on debt) was raised from three-eighths to one-half.

2. The fixed assignments of the various provinces were reduced by the amount which these changes of classification added to the provincial share of growing revenue.

The financial effect of these arrangements was to convert fixed assignments amounting to $3\frac{1}{2}$ lakhs of rupees into growing net revenue, and to deprive the Imperial Government in future years of an annual net increment of 8·15 lakhs in its share of divided revenues.

Having remedied the defects of the existing system, the Government of India approached the task of imparting greater permanency to their financial relations with the Provincial Governments. They realised that complete permanence was not attainable. The possibility of famine constituted a danger to the contracts against which it was impossible to provide adequate safeguards. The Government of India agreed that, in the case of a widespread and serious calamity, it would step in and supplement the provincial resources, and that the contract obligations would, for the time being, remain practically in suspense. Subject, however, to provision against famine, the Government of India considered that the settlements, as now revised, might safely be declared to be fixed in perpetuity. With the introduction of this element of fixity into their financial relations, it was hoped that it would be possible to allow provincial authorities far greater independence within definite limits, and to relax a great measure of the control which the Government of India had hitherto exercised over provincial bodies.

The nature and probable effects of the new system were described by Sir Guy Fleetwood Wilson in these words: "It will also, I trust, be a measure of real decentralization and administrative reform. It will give Local Governments a more abiding interest in managing and directing their own resources; it will

greatly reduce the occasions for interference by the Central Government; and it will stimulate provincial independence and self-reliance. To the Government of India also it ought to mean much. It will relieve us from the unforeseen and indeterminate liability to which the imperial revenues were formerly exposed by the financial difficulties of any individual province. To that extent it frees our hands for the closer regulation of our imperial expenditure; and it enables us to lay down the lines of a consistent financial policy for the future. It marks a forward stage in the development of a political theory which has been steadily pursued for the last forty years. But it implies something more than theory; for I believe that the new arrangements will be found to be liberal by the provinces; and I regard them as necessary in justice to ourselves and to the general tax-payer of India."

One important modification had to be introduced into the settlements immediately after they had been made. The re-partition of Bengal and the subsequent reconstitution of the provinces of Bengal, Behar and Orissa, and Assam necessitated the abrogation of permanent settlements entered into with them and the formation of new and temporary settlements.[1]

[1] The Finance Member explained to the Council why it was impossible to endow the new arrangements with the same permanency as in the older provinces. He said: "In Behar and Orissa, there must be a considerable amount of initial expenditure before the

These temporary settlements were made on the ordinary lines. It was arranged that in each of the three provinces the imperial exchequer would receive one-half of the receipts from land revenue and one-half of the net receipts from stamps and assessed taxes. In Bengal as well as in Behar and Orissa, the Government of India would take half the net irrigation revenue as well, and in the latter province one-quarter of the net receipts from excise. All other revenue and expenditure would be wholly provincial. These shares were fixed with a view to bringing the provincial accounts as near to equilibrium as possible, so that the Provincial Governments might get full advantage of their growing revenues. Besides distributing the existing balances, the reserves of the new provinces were strengthened by initial grants aggregating £782,000. The provinces thus started their accounts for 1912-13 with the following opening balances: Assam, £267,000; Behar and Orissa, £833,000; Bengal proper, £1,000,000.[1]

province settles down to normal conditions, and in Assam it will be some little time before we can estimate the permanent requirements of a tract which shows promise of important developments. Moreover, the methods adopted in framing the settlement standards were of necessity in some measure tentative and provisional. The arrangements which we have concluded, therefore, are for three years, in the hope that, after the period expires, it will be possible to gauge the needs of the new provinces with sufficient accuracy to justify us in giving them permanent settlements." *Vide Financial Statement*, 1912-13.

[1] These figures excluded the grants made from the opium windfall

With the approval of the Secretary of State, the following rules were laid down in 1912 to govern the future relations between imperial and provincial finance :[1]

(*i*) With the exception indicated in Rule 11, the provincial settlements for Madras, Bombay, the United Provinces, Burma, the Punjab, and the Central Provinces would in future be permanent and not subject to revision; and permanent settlements would be framed, as soon as might be found convenient, for Bengal, Behar and Orissa, and Assam. In case of serious famine in a province, the question of assistance from the revenues of the Government of India would be considered. The Government of India reserved the right to call for assistance from provincial revenues in the event of grave embarrassment in their own finances.

(*ii*) When the fixed assignment of a province became unduly large and hampered the expansion of its revenue, as compared with the legitimate and necessary growth of expenditure, it

in the year; and the Bengal figure included £267,000 held for the Calcutta Improvement Trust. Behar and Orissa was treated well because it needed substantial assistance in the task of establishing a new headquarters. Assam was a country of much promise, where it was expected that judicious expenditure on communications and colonising would amply repay itself in time. Bengal proper had been contending for some years against serious financial difficulties which, the Finance Member said, the Government of India was glad to mitigate, particularly, if thereby the steady improvement of the administration in the eastern districts could be facilitated.

[1] *Financial Statement, 1911-12.*

would ordinarily be converted, either in whole or in part, into a share of growing revenues as soon as the state of imperial finances might permit.

(*iii*) In the event of a grant of special allotments to Local Governments out of surplus revenues not required for the remission of taxation, the reduction of debt, or other purposes, the Government of India would retain the option of declaring the purposes for which the money was provided; but

(*a*) the grants would not involve greater interference by the Central Government than existed at the moment;

(*b*) they would be allotted with due regard to the wishes of the recipient Government; and

(*c*) they need not necessarily be devoted to one and the same purpose in every province.

(*iv*) A Provincial Government might not budget for a deficit, unless it satisfied the Government of India that the excess expenditure was due to an exceptional and non-recurring cause, and also, in case the deficit involved a reduction of the provincial balance below the prescribed minimum, that suitable arrangements would be made for the restoration of the minimum.

(*v*) If a Provincial Government exhausted its own balances and received permission to overdraw upon the general balances, it would be required to take the necessary amount as a short loan from the Government of India. Such loan would bear

interest and would be repayable in such instalments as the Central Government might direct.

(*vi*) Future corrections in provincial budgets by the Government of India would be restricted to

(*a*) divided heads, and

(*b*) the proposed totals of revenue and expenditure.

These rules, although they did not mark the adoption of a new policy, represented a decided advance on the path of decentralisation. They placed a greater responsibility on Provincial Governments for the stability of their finances, while at the same time investing them with wider independence.

On the question of provincial taxation, the Government of India said that it did not see any strong reason for removing the safeguards which then surrounded its imposition. It recognised, however, that financial autonomy for the provinces, if and when it came, must carry with it the power of taxation. The Government of India thought that, in the then existing circumstances, there was nothing to be gained by diminishing its control, either executive or legislative.

The Government of India refused to accede to the proposal of some Provincial Governments to concede to them the power of provincial borrowing, because, in its opinion, the drawbacks attaching to the proposal were much greater than the possible advantages which might accrue from it. It

thought that it would be extremely difficult to prevent a provincial loan from competing with imperial loans. A further objection lay in the undesirability of increasing the non-productive debt of India.

The Government of India, in accordance with the recommendation of the Decentralisation Commission, authorised the Provincial Governments to delegate to their heads of departments certain powers of reappropriation. At the same time, the limits imposed on the spending powers of the Provincial Governments were widely extended by separate orders issued on the subject.

The year 1912-13 turned out to be one of great financial prosperity. There was a large surplus in the accounts of the Government of India. The Finance Member, therefore, decided to make the provinces partners in the good fortune of the Central Government. He distributed the following sums to the provinces: two and a half crores for non-recurring expenditure on education, half a crore for urban sanitation, 30 lakhs to Burma for communications, 20 lakhs to Assam for development and one crore in aid of general provincial resources. The last-mentioned grant was distributed at the rate of twelve lakhs to each of the larger provinces, and eight lakhs to each of the smaller ones, and was not earmarked for any one purpose. Besides these grants made out of the surplus of the previous year, Sir Guy

Fleetwood Wilson distributed further grants of a recurring character to the provinces out of the budgeted surplus for 1913-14. He allotted one crore for recurring expenditure on education and sanitation, ten lakhs for agricultural improvement, and ten lakhs for medical relief. Finally, he made assignments to the provinces to enable them to forego the amounts which they were then appropriating for provincial use from the cesses on land.[1]

The policy of "doles," however, continued to be adversely criticised. In 1914, Sir Ibrahim Rahimtoolla observed that the system was open to serious objection. He suggested that the divided heads of revenue should be made over to the provinces, and contributions levied from them for imperial expenditure, the total amount of such contributions being fixed under normal conditions and increased in special circumstances. The contribution of each province was, in his opinion, to be determined with reference to its population, needs, and income per head.[2]

[1] The assignments to the different provinces were as follows: Bengal, 25 lakhs; Behar and Orissa, 23 lakhs; the United Provinces, 29½ lakhs; the Punjab, 2 lakhs ; Total 79½ lakhs.

[2] He said: "It appears to me that though such a system is admirably suited to maintain the high dignity of the Government of India as it enables them to take money from the provinces out of their revenues in many cases in excess of their requirements, and then having taken the money in this way it is distributed in the form of doles and bounties, for sanitation, education, and other purposes, and in that way they earn the thanks of the Provincial Governments and

The European War which broke out in August, 1914, disturbed the finances both of the Government of India and the Provincial Governments. In 1915, it was decided, with the concurrence of the Provincial Governments concerned, to extend the temporary financial settlements with Bengal, Behar and Orissa, and Assam, which would normally have been put on a permanent basis from the 1st April following. The reason was, of course, that this was not the opportune moment for dealing with permanent settlements, which could be much more safely formed when the Government of India would be in a normal financial condition. A modification was, however, made in the Burma settlement, for it had not proved quite so favourable as the permanent settlements with the other provinces. An arrangement was made with the Burma Government by which it handed over to the Government of India a crore of rupees in exchange for a fixed assignment of three and a half lakhs of rupees a year.

In 1918, the Finance Member, Sir William Meyer, made an important announcement in the course of his budget speech. He said: "We have under consideration, for application after the war is over and in connexion with the scheme of constitutional reforms, a material advance in the

provincial representatives for their great generosity, it can hardly be regarded as a correct or just system." *Vide Proceedings of the Indian Legislative Council, 1914.*

direction of separating provincial and imperial finance, which will give the provinces larger and more independent resources, with the further power of supplementing these by taxation when such may be found necessary." The scheme prepared by Sir William Meyer with the assistance of Mr. Howard, while it sought to give separate resources to the Central and Provincial Governments, did not do away with divided heads of revenue. But a different scheme was subsequently prepared by the Government of India.

CHAPTER VI

ON THE EVE OF THE REFORMS

The financial arrangements which subsisted between the Government of India and the Provincial Governments at the close of the Great European War were the result of a series of experiments extending over half a century. These settlements, however, had no statutory basis or legal validity. They were merely in the nature of understandings between the Government of India and its subordinate authorities arrived at for the sake of administrative convenience. While this system was a considerable improvement upon the system of complete centralisation which prevailed between 1834 and 1870, it was inadequate to the requirements of the new policy adumbrated in Mr. Montagu's famous Announcement of the 20th August, 1917. These settlements, it is true, ensured a certain amount of financial devolution, but they failed to secure to the provinces any substantial measure of financial freedom.

An examination of the system revealed certain shortcomings of a serious character. In the first place, provincial settlements were based not on

provincial revenues, but on provincial needs. The Government of India being ultimately responsible for the financial solvency of the whole country, it could not allow any province to go bankrupt. It was thus necessary for the Central Government to retain its control over provincial expenditure. One of the chief instruments by which this control was exercised was a series of codes of instructions, which imposed definite restraints upon the powers of Provincial Governments to create new appointments or to raise emoluments. Secondly, in regard to income, so long as the Government of India took a share in the proceeds of the taxes, it had a strong motive for interfering in the details of revenue administration. Besides, the Central Government possessed full power of control over taxation. The Government of India Act forbade provincial legislatures, without the previous sanction of the Governor-General, to consider "any law affecting the public debt of India or the customs or duties or any other tax or duty for the time being in force and imposed by the authority of the Governor-General in Council for the general purposes of the Government of India." It is true that a provincial legislature was not legally debarred from exploiting for provincial purposes any new source of taxation; but even such proposals of taxation required the sanction of the Secretary of State and of the Governor-General in Council. This power of controlling taxation naturally led to

a system of close subordination in which the Provincial Governments were held. Thirdly, the provinces were denied the power of borrowing. As has already been noticed, the main reason for this restriction was that the revenues of India being legally one and indivisible, the Provincial Governments possessed no separate resources of their own on the security of which they could borrow. There were also strong practical reasons for not conceding borrowing power to the provinces. The loan market was limited, and competition in the same field of several authorities was likely to force up the rates. The practice was, therefore, observed of reserving entry to the public loan market entirely for the Central Government, from whom all moneys required for provincial purposes were borrowed.

The authors of the Report on Constitutional Reforms felt that, if the popular principle in administration was to have fair play in the provinces, it would be necessary to alter the financial relations which then existed between the Central and Provincial Governments. They observed: "The present settlements by which the Indian and Provincial Governments share the proceeds of certain heads of revenue are based primarily on the estimated needs of the provinces, and the Government of India disposes of the surplus. This system necessarily involves control and interference by the Indian Government in provincial

matters. An arrangement which has on the whole worked successfully between two official Governments would be quite impossible between a popular and an official Government."[1] The first aim, therefore, of Mr. Montagu and Lord Chelmsford was to find some means of entirely separating the resources of Central and Provincial Governments. They started with a change of standpoint. They recognised that, if provincial autonomy was to mean anything real, clearly the provinces must not be dependent on the Government of India for the means of provincial development. The settlements in vogue at the moment provided only for the ordinary growth of expenditure, but for any large and costly innovations Provincial Governments had to depend on "doles" out of the all-India surplus.

The authors of the Joint Report thought that a fundamental change was needed in the system of provincial finance. They proposed that an estimate should first be made of the scale of expenditure required for the upkeep and development of the services which clearly appertained to the all-India sphere, that resources with which to meet this expenditure should be secured to the Central Government, and that all other revenues should then be handed over to the Provincial Governments, which would thenceforth

[1] *Report on Constitutional Reforms, Ch. VIII.*

be wholly responsible for the development of all provincial services.

It would not be enough, however, to distribute the existing resources on a different basis, but it was necessary to give to the Central and Provincial Governments entirely separate resources. Brushing aside all theoretical as well as practical objections to their scheme, the authors of the Joint Report decided to adopt a system of complete segregation of sources of revenue. Of the heads of revenue which were, till then, divided, they decided to make excise [1] provincial throughout India. They thought it desirable to discriminate the stamp duty under the sub-heads general and judicial, making the former a central and the latter a provincial receipt. Land revenue presented some difficulty, but it was ultimately decided to make it wholly provincial. The revenue derived from irrigation, being closely connected with land revenue, was also made provincial, the expenditure under this head as also the liability for famine relief being at the same time thrown on the provinces. With regard to the one remaining head, namely, income-tax, the authors of the Joint Report held, in opposition to the views of most of the Provincial Governments, the opinion that there existed very strong reasons for making it a central source of revenue. In the first place, they thought

[1] Excise was at this time a provincial head of revenue in Bombay, Bengal and Assam.

there was the necessity of maintaining a uniform rate throughout the country. Secondly, in the case of ramifying enterprises with their business centre in some big city, the province in which the tax was collected was not necessarily the province in which the income was earned. While the joint authors admitted the force of some of the arguments which were advanced in favour of making income-tax a provincial or a divided head of revenue, they refused to let these stand in the way of making it a central resource.

As a result of this scheme of distribution, it was anticipated that there would be a large deficit in the Government of India's budget. The different ways of meeting this deficit were then considered. The first was to maintain the basis of the then existing settlements, but to allot to the Government of India a certain proportion of growing revenue instead of a share of the divided heads. It was, however, feared that this device would tend to stereotype the existing inequalities between the provinces, while it was also likely to introduce an element of great uncertainty into the finances of the Government of India. A second suggestion was that an all-round contribution should be taken on a *per capita* basis. This expedient also could not obviate very undesirable variations between provinces in the rate of levy owing to the inequality of provincial resources and of provincial needs. A third plea was to take an

all-round percentage contribution based on gross provincial revenues. This was considered to be open, *inter alia*, to the objection that it would leave several of the provinces with large deficits. The fourth proposal, namely, that provinces which had a surplus should temporarily help the Government of India was rejected as cumbrous and impracticable.[1]

On an examination of the various proposals, the authors of the Joint Report came to certain broad conclusions. They agreed that, in fixing contributions, it was undesirable to pay regard to the growing revenues of the provinces. The joint authors agreed also that the contributions should be of fixed amounts. They saw that equality of contribution was impracticable, because there was no clean slate to write upon. They, therefore, looked for some plan which would fit closely into the existing facts. Starting with an estimate (based on the budget figures for 1917-18, subject to some adjustments) of the gross revenues, of all the provinces under the new system of allocation, and deducting therefrom an estimate of the normal expenditures of all the provinces, they arrived at Rs. 15·64 crores as the gross provincial surplus. The deficit in the Government of India's budget was estimated at Rs. 13·63 crores. This left Rs. 2·01 crores, or about 13 per cent. of the total gross surplus as

[1] *Report on Indian Constitutional Reforms, Ch. VIII.*

the net surplus available to the provinces. The authors of the Joint Report proposed to assess the contribution for each province to the Government of India as a percentage of the difference between the gross provincial revenue and the gross provincial expenditure. On the basis of the figures taken by the authors, this percentage would be 87. The way in which this plan would work out in practice would be gathered from the following figures :—

(*In lakhs of rupees.*)

Province.	Gross provincial revenue.	Gross provincial expenditure.	Gross provincial surplus.	Contribution (87 per cent. of col. 4).	Net provincial surplus.
1	2	3	4	5	6
Madras	13,31	8,40	4,91	4,28	63
Bombay	10,01	9,00	1,01	88	13
Bengal	7,54	6,75	79	69	10
United Provinces	11,22	7,47	3,75	3,27	48
Punjab	8,64	6,14	2,50	2,18	32
Burma	7,69	6,08	1,61	1,40	21
Bihar and Orissa	4,04	3,59	45	39	6
Central Provinces	4,12	3,71	41	36	5
Assam	1,71	1,50	21	18	3
Total	68,24	52,64	15,64	13,63	2,01

The authors of the Report apprehended that the objection would be taken that some provinces

would under the scheme bear a very much heavier proportion of the cost of the Central Government than others. But their answer was that the objection was one that applied to existing inequalities which their scheme failed to remove. In their opinion, the great merit of the proposed settlement was that it would immediately improve the position of the provinces as a whole by over 2 crores. They further added that this arrangement was not to be of a final nature; but that, when revenues would develop, a revision would take place under normal conditions, and an opportunity would occur for smoothing out inequalities. The joint authors admitted that, inasmuch as the proposals were based on war figures, they should be open to revision at a later period, and they suggested that it would be one of the duties of the proposed statutory commission to re-investigate the question of provincial contributions. They added that, in case of an emergency, the Central Government would have the power to make a special supplementary levy upon the provinces.[1]

It naturally followed from this proposal that there would, under the new arrangements, be a complete separation of the central and provincial budgets, and that the former would thenceforward include only the direct transactions of the Government of India and not those of the provinces as

[1] These proposals, of course, referred only to the Governor's Provinces and not to the minor administrations.

had hitherto been the case. It likewise followed that there would be no more ear-marking of any portion of provincial balances and that portions previously ear-marked would be available for general purposes.

But the mere provincialisation of heads of revenue and expenditure was not of itself sufficient to free the provinces from the restrictions on their spending powers, which the provisions of the codes and other standing orders had imposed upon them. The Government of India had itself to conform to the restrictions on expenditure imposed by the Secretary of State in Council, and could, therefore, enlarge the powers of the Provincial Governments only to a minor extent. It was thus necessary to relax the India Office control in order to give the provinces a relatively free hand in expenditure, and proposals were put forward for this purpose.

It was also considered necessary to enlarge the taxing powers of Provincial Governments. Mr. Montagu and Lord Chelmsford thought that the best means of giving freedom to these Governments in this respect would be to schedule certain subjects of taxation as reserved for the provinces, and to retain the residuary powers in the hands of the Central Government. They expressed the view that, where a tax fell within the schedule, the Government of India's previous sanction to legislation required for its imposition should not be necessary; but in cases not covered by

the schedule, the Government of India's sanction should be sought before the necessary legislation was introduced.[1]

On the question of borrowing, the Provincial Governments were unanimous in desiring greater freedom. The authors of the Reforms Report thought that, in order to avoid harmful competition, the Provincial Governments should continue to do their borrowing through the Government of India. But they were prepared to allow the Provincial Governments access to the Indian market, if the Government of India should find itself unable to raise the money in any one year which a province required, or if there was good reason to believe that a provincial project might attract money which would not be elicited by a Government of India loan. They advised that, in such a case, the Provincial Governments should secure the approval of the Government of India to the method of borrowing, including the rate of interest, as well as the time of borrowing, so as not to conflict with the Central Government's loans.

On the difficult question of budget procedure within a province, the authors of the Joint Report

[1] The authors of the Joint Report thought this sanction should be withheld only if the proposal trespassed on central heads of revenue; or if the tax was a new one and the Central Government itself contemplated imposing it as an all-India tax; or if the proposals were, in the opinion of the Government of India, likely to lead to undesirable consequences which would affect its own responsibilities. *Vide Report on Constitutional Reforms, Ch. VIII.*

felt that there must be means of securing to the Executive Council the money necessary for keeping the administration of the reserved subjects efficient, and also of ensuring that a fair proportion of the total revenue was devoted to the expanding cost of the transferred departments. After examining various expedients,[1] they put forward the scheme of a joint purse with preferential treatment for the reserved departments. This arrangement can be best described in the words of the Report. "We propose," said the joint authors, "that the provincial budget should be framed by the Executive Government as a whole. The first charge on provincial revenues will be the contribution

[1] The authors of the Joint Report observed in this connexion: "We were attracted by the possibility of appointing a joint committee representing both official and non-official views to make a financial settlement dealing with both reserved and transferred subjects, which should hold good for a period of say six years, always supposing that it can be varied meantime by agreement, confirmed by the assent of the legislative council. We were anxious to find some solution for the difficulties and friction which might otherwise annually occur between the two elements in the Government which are responsible for the reserved and transferred services. The device of reference to the Government of India we dismiss as being a negation of our leading principle of provincial autonomy. It seems to us even more idle to suggest a settlement by process of laying papers before Parliament. It has also been proposed that disputes might be composed by an internal tribunal within the province, comprising a high court judge, a Government official, and an elected member; but we dismiss such an expedient from consideration, because so long as the Governor-in-Council is responsible for reserved subjects, we hold that he must have power to decide what revenues he requires. On full consideration we have decided to set aside all suggestions for a settlement." *Ch. VIII, para. 255.*

to the Government of India; and after that the supply for the reserved subjects will have priority. The allocation of supply for the transferred subjects will be decided by the ministers. If the revenue is insufficient for their needs, the necessity of new taxation will be decided by the Governor and the ministers. We are bound to recognise that in time new taxation will be necessary, for no conceivable economies can finance the new developments which are to be anticipated. The budget will then be laid before the council which will discuss it and vote by resolution upon the allotments. If the legislative council rejects or modifies the proposed allotment for reserved subjects, the Governor should have power to insist on the whole or any part of the allotment originally provided, if for reasons to be stated he certifies the necessity in the terms which we have already suggested. We are emphatically of opinion that the Governor in Council must be empowered to obtain the supply which he declares to be necessary for the discharge of his responsibilities. Except in so far as he exercises this power, the budget would be altered in accordance with the resolutions carried in council." [1]

The subject of provincial finance was discussed at considerable length by the Government of India in its First Despatch on constitutional Reforms.

[1] *Report on Constitutional Reforms, Ch. VIII.*

Lord Chelmsford and his colleagues held the view that, given a dualistic structure of the Provincial Government, the new financial system should be based on three leading principles, namely, first, that internal control over provincial finance must be withdrawn in the largest possible measure; second, that within the province each half of the Government should have a defined power of raising the revenue to provide for the expenditure which it considered necessary; and third, that during the period of training and advance in political experience, the people must be protected from unjustifiable financial burdens.

In regard to the first principle the Governor expressed himself in full accord with the proposals contained in the Report on Constitutional Reforms which had also met with general approval in India. But he made important reservations in regard to the actual working of these recommendations. He said: "We must, however, make it perfectly clear that, under these new arrangements, our own responsibility will be appreciably narrowed. We recognise that, helped by the audit we shall still have a general responsibility for financial propriety and the avoidance of wasteful or extravagant expenditure. We also recognise that we are answerable for it that a province does not become insolvent or unpunctual in paying its debts. These duties rest upon us so long as we are responsible

to Parliament for the good administration of India. We conceive, however, that, with the grant of this new financial liberty to the provinces, we shall no longer be required to watch their financial proceedings in detail, or to enforce from day to day measures which may seem to us necessary to correct financial error. Our intervention in future will take the form mainly of advice and caution; though we cannot ignore the ultimate call that may be made upon us in extremities to issue definite orders which a province must obey if it wishes to retain its constitution."[1]

Turning to the question of financial adjustments, the Government of India accepted the principle of abrogating the complicated division of revenues and of establishing a clear line of demarcation of central and provincial resources. Nor was any objection taken to the proposal to allocate the provincial contributions on the basis taken in the Report, namely, an all-round ratio of the gross provincial surplus. The Government of India recommended, however, that the initial contributions should be recognised as temporary and provisional, and that steps be taken as soon as possible to fix a standard scale of contributions towards which the provinces would be required to work by stages. It further suggested that a Committee on Financial Relations might be appointed to advise fully upon the subject.

[1] *First Despatch on Constitutional Reforms, p. 30.*

The Government of India accepted the proposal to schedule the taxes for the imposition of which a province would require no special sanction, and suggested that in that category might be placed succession duties, taxation of unearned increment on land, taxes on advertisements, amusements and specified luxuries; and generally any supplement to revenues which were already provincial, such as land cesses, higher court-fees, increased charges for registration, and enhanced duties upon articles upon which the excise was not regulated with reference to the tariff schedule. The list was not exhaustive, and the Government of India thought that the schedule might be extended from time to time. In case a provincial tax encroached upon the sphere of central taxation, the veto could be employed.

The limits which the Report on Constitutional Reforms proposed upon the future liberty of raising loans by a Provincial Government had the entire concurrence of the Government of India. It refused to accept the suggestion made by some Provincial Governments that they should be given unfettered powers of borrowing for provincial purposes. In regard to the contention that the Government of India, when called upon to accord sanction to a provincial loan, should not scrutinise the purpose for which the loan was required, it expressed its views in these words: " In years when the demand for loans exceeds the offers,

we must undertake some rough measuring of the relative merits of the proposed expenditure before we make the final allotment. So far as is possible, we should endeavour to refrain from questioning the discretion of a province; and it will probably be helpful to lay down certain general rules. For example, priority would inevitably be given to a loan required for famine purposes, or to finance what is technically known as the Provincial Loan Account. It might also with propriety be laid down that a province is not to borrow except for capital purposes, that is, for obtaining a permanent asset of a material character. In the case of unproductive debt the establishment of sinking funds should also be prescribed. Some such rules would relieve us of much detailed scrutiny; while if they were infringed by a province which has been permitted to borrow in the open market, its action would be challenged in audit, and treated as failure to discharge its responsibility for maintaining solvency."

In this despatch the Government of India expressed its desire to relax the firm hold which had so far been retained over provincial balances, and suggested that the existing system of control might be replaced by a few simple regulations. It also considered it desirable that, under the new regime, each province should take over its Provincial Loan Account and provide its own finance for such transactions.

Coming to the distribution of resources between the two halves of a Provincial Government, the Government of India pointed out the various difficulties that were likely to arise from the system of common pool suggested in the Joint Report. It also referred to the criticism which had been levelled against the proposed system under which the transferred departments were asked to live upon the crumbs that would fall "from the table of the richer reserved departments," and the invidious burden that would be thrown on ministers who would be "solely responsible for the unpopular business of taxation." It, therefore, urged the abandonment of the scheme of the Joint Report and recommended a "separate purse" system instead of a joint purse. The essential features of this system were these: First, an examination of the balance at the credit of each half would be made, and after the necessary adjustment the free balance would be divided between the two halves of the Government. The second stage would be the definite allocation to each half of the Government of the receipts from the reserved and the transferred subjects respectively. The third stage would be to determine the division of the surplus. The fourth stage would be to estimate the normal expenditure for reserved and transferred departments respectively; and if the revenues required for meeting such

expenditure in either department were not in normal circumstances to be obtained from its own income, the difference was to be made good by an assignment from the revenues of the other department. Such an assignment, ordinarily speaking, would take the form of a definite fraction of some head of growing revenue, or failing that, a lump sum subsidy. An arrangement of this sort would, the Government of India thought, be both "workable and simple." [1]

In the opinion of the majority of the Council of the Governor-General, friction could still further be diminished by taking another step in the process of allocating resources. This step would be the fixation for a period of years of the adjustment

[1] The advantages of this scheme were thus summarised in the First Despatch on Constitutional Reforms: "It seems to us to be free from all the main objections which we found in the pooling system. It allows each half of the Government to forecast its expenditure with a sure knowledge of the revenue which will be available to cover it. It informs them what part of the provincial balance they may draw upon. It is compatible, as will be shown below, with their enjoying the proceeds of their own taxation, obtaining their own loans and accepting full liability for repayment of the money they borrow. It gives each half of the Government a direct interest in improving the sources of revenue which were placed in its charge. Finally, it narrows down to the mere question of a single adjusting figure the field of financial conflict between the two halves of the Government, and thus largely reduces the opportunity for friction inherent in the scheme of the Report. We may add, as will appear from para. 73 below, that it does not remove reserved expenditure from the purview of the legislature."

between the two halves of the Government.[1] A further recommendation of the Government of India was that there should be a clear allocation of responsibility and results in the matter of taxation and borrowing, each half of the Provincial Government being given freedom, subject to the approval of the Governor, to levy a new tax or to raise a loan for its own purposes. One member of the Governor-General's Council, Sir Sankaran Nair, appended a Minute of Dissent to this Despatch in which he pointed out that this scheme was likely to give inadequate resources to the transferred departments and was calculated to place the ministers in a position of subordination to the executive council.[2] He also opposed the scheme on the ground that it would

[1] It was stated further:

"It would, for example, be determined for three or five years whether ministers should receive 15 per cent. of the land revenue to balance their requirements, or whether the reserved departments would have to be placed in a position of equilibrium by receiving, say, 10 per cent. of the excise revenue collected by ministers." *First Despatch on Constitutional Reforms, para. 71.*

[2] "The main sources of revenues," he wrote, "like the land revenue, in the provinces will be under the control of the executive council while all the departments of expenditure, like education, local self-government, including public health and public works, will be under the control of ministers. These are the departments which stand in need of development. In normal circumstances, therefore, the revenue which they require will have to be made good to them by the executive council. This places the ministers practically under the control of the executive council. The minister or ministers will not be able to raise money even by taxation without the consent of the Governor....According to my colleagues their proposal will give the

take away real popular influence from the settlement of the budget.

The withdrawal of external control over provincial finance implied the substitution of effective control within the province. That control, according to the scheme outlined in the First Despatch, was to be divided between the finance department and the legislature. The finance department would be one and undivided, and it would be a reserved subject. Very important functions were to be assigned to this department. The second guardian of financial propriety in a province was to be the legislative council, which would appoint a Committee on Public Accounts. Standing behind all financial control there was to be an effective system of audit.

A Committee [1] was appointed by the Secretary of State to consider and report on questions connected with the division of functions between the Central and Provincial Governments as well as the distribution of administrative work between the

ministers a direct interest in improving the sources of revenue which are placed in their charge, but the sources of revenue which are capable of expansion will be, according to the proposals, placed not in their charge but in the charge of the executive council. There will, therefore, be no resources to be developed except perhaps excise revenue which it should not be our policy to regard as a source of growing revenue. Further, I do not accept this theory that all inducement must be held out to a department to increase its revenue for its own benefit." *Vide First Despatch on Constitutional Reforms.*

[1] Lord Southborough was appointed President of this Committee as well as of the Franchise Committee. But, as a matter of fact, Mr. Richard Feetham acted as Chairman of the Committee.

two halves of a Provincial Government. This Committee devoted considerable attention to the question of finance. A Memorandum prepared by Mr. (now Sir Frederick) Gauntlett was transmitted to this Committee.[1] This Memorandum indicated the views of the Government of India on provincial finance, and dealt with (*i*) accounts and audit, (*ii*) the position of the Finance Department in the Provincial Government, (*iii*) taxation for provincial purposes, (*iv*) borrowing on the sole credit of provincial revenues, and (*v*) control over the provincial balances. The Feetham Committee expressed themselves in general agreement with the proposals contained in the Memorandum, but offered suggestions in regard to some of the details.

The proposals of the Reforms Report were embodied in a Government of India Bill which was referred to a Joint Select Committee of both Houses of Parliament. Evidence was tendered

[1] Among other things, Mr. Gauntlett's Memorandum touched on a suggestion which had been made that, in order to mark the relations of the Finance Department with both parts of the Government of a province, it should be placed under a sort of Treasury Board, consisting of one Member of Council and one Minister. The idea was rejected as impracticable, as "it would lead to delays, divided decisions, and unnecessary opportunities for friction." The Government of India reiterated the proposal made in the First Despatch that the dual interests of the Finance Department could be effectively safeguarded by the appointment of a Second or Joint Secretary, in addition to the regular Finance Secretary, whose business it would be to act as financial adviser in all cases coming from departments under the control of ministers.

before this Committee from various points of view. In their Report the Joint Committee observed that doubts had been expressed in several quarters regarding the financial adjustment proposed between the Central and Provincial Governments in India. They endorsed the recommendation of the Government of India that a fully qualified financial commission should be appointed to advise as to the principle on which contributions from the Provincial Governments to the Central Government should be adjusted. They urged the formation in each province of a strong department of finance which would serve both sides of the Government alike. On the question of the distribution of revenues and balances between the two halves of a Provincial Government, they advised that if the Governor, in the course of preparing either his first or any subsequent budget, found that there was likely to be a serious or protracted difference of opinion between the executive council and the ministers, he should be empowered at once to make an allocation of revenue and balances between the transferred and reserved subjects, which should continue for at least the whole life of the existing legislative council. The Committee did not endorse the suggestion that certain sources of revenue should be allocated to reserved, and certain sources to transferred subjects; but they recommended that they should allocate a definite proportion of the total revenue which might be

two-thirds to reserved and one-third [1] to transferred subjects, and similarly a proportion, though not necessarily the same fraction, of the balances. In case the Governor desired assistance in making the allocation, the Committee suggested that he should be allowed to refer the question to an expert to be appointed by the Governor-General. The Committee, further, expressed the opinion that, until an agreement had been reached or an allocation had been made by the Governor, the total provisions of the different heads of expenditure in the budget of the province for the preceding financial year should hold good.

After the passing of the Act of 1919 and before the rules under the Act were framed, the question of financial relations between the Central and Provincial Governments was referred by the Secretary of State for India to a Committee consisting of Lord Meston (President), Mr. Charles Roberts, and Mr. E. Hilton Young. The terms of reference were as follows:

To advise on:—

(*a*) The contributions to be paid by the various provinces to the Central Government for the financial year 1921-22;

(*b*) the modifications to be made in the provincial contributions thereafter with a view to

[1] These fractions were used by the Committee by way of illustration.

their equitable distribution until there ceases to be an all-India deficit;

(*c*) the future financing of the Provincial Loan Account;

(*d*) whether the Government of Bombay should retain any share of the revenue derived from income-tax.[1]

When the Committee on Financial Relations was about to commence its enquiry, the Government of India revised its previous estimate of the deficit in the central budget and put it at 6 crores. This figure was less than half of the deficit of 13·63 crores estimated in the Montagu-Chelmsford Report.[2] The new estimate was arrived at by recasting the budget for the year 1920-21 on a two-shilling rupee basis and eliminating from the receipts the estimated collection of arrears of excess profits duty and from the expenditure non-recurring items amounting to 186 lakhs. It was emphasised that the deficit thus calculated was the irreducible minimum required in the then existing circumstances to balance the budget. Indeed, the Government of India had reduced the deficit to a figure which, they feared, might prove dangerously low.

[1] Clause (*d*) of the instructions was a later addition made at the instance of the Government of Bombay, and was communicated to the Committee after it had finished a part of its enquiries.

[2] Paragraph 206.

All the Provincial Governments and various public bodies made representations to the Committee on Financial Relations. They subjected the financial proposals of the Joint Report to criticism from various points of view. Each Provincial Government placed before the Committee its own needs and pointed out its special circumstances. The Government of Madras not only pressed its own claims, but went out of its way to criticise the representations of the other Governments. Evidently, this was done in order that Madras might be able not only to retain what had been proposed to be given to her but to get more concessions. The case put forward by Mr. (afterwards Sir) Charles Todhunter on behalf of Madras was on the following lines: The Government of Madras doubted whether there would be any imperial deficit at all. Even if there was a deficit at the outset, it was likely to be covered by the expansion of imperial revenues, which included all the most elastic heads of taxation. Failing that, it should be met by the increased imperial taxation. If any contributions were to be levied, Madras should not be asked to bear a portion of such levy, for the future needs of Madras were very great, and she would require every rupee of her revenues. It was suggested that the first levy should be on the provincial balances, and the next step should be for the provinces to take over a portion of the public debt equivalent to the

Provincial Loan Account, so as to set free imperial moneys locked up. If in the last resort, a levy was to be made on current revenues, it should be in proportion to expenditure. It was suggested that a levy based on the net improvement of revenues under the new dispensation would be most unfair. Lastly, it was urged that, in view of the probability of an increase, on the one hand, of imperial revenue and, on the other, of provincial expenditure, any contribution that might be made should be regarded as a loan repayable with interest.[1]

Mr. Todhunter referred to the argument advanced by certain provinces to the effect that because they would pay larger sums in income-tax and customs to the Government, they should pay less out of the taxes that were levied at the discretion of the Provincial Governments. He remarked that the conclusion to be drawn from this fact was the exact opposite. He observed: "The test of fitness of a province to contribute is its wealth and two main tests of wealth are income and consumption of luxuries. If, therefore, it is a fact that the incomes that pay tax in Calcutta and Bombay are earned in Bengal and Bombay, and that a large proportion of the goods that pay duty in those provinces is consumed in them, that fact seems to afford an unanswerable argument for

[1] *Memorandum from the Madras Government, dated the 24th February, 1920.*

increasing, and not for reducing, their contribution."[1] In other words, the Government of Madras urged that where the indirect contributions were large, the direct contributions should also be large, and *vice versa*. The ingenuity of this argument really deserves to be admired.

The Government of Bengal submitted a representation in the course of which it said that the financial arrangements proposed in the Montagu-Chelmsford Report were extremely unfair to Bengal, and urged that more adequate resources should be placed at the disposal of the province. In regard to the question whether the incidence of income-tax revenue could be traced with any approximation to accuracy, it subsequently presented a Note on the income-tax assessments which proved conclusively that certainly over 90 per cent. of the income-tax collected in Calcutta could justly be claimed as coming solely from Bengal.

On the last of these points several of the Provincial Governments urged before the committee that the yield from income-tax was the only direct contribution to their public revenue which was made by the industrial wealth of their provinces; and Governments which administered great mercantile and manufacturing centres like Calcutta

[1] *Annexure 3 to Enclosure 9. Vide Cmd. 974.*

and Bombay claimed special consideration for the heavy expenditure in which those centres involved them. To these arguments the Bombay Government added their apprehension that a time might come when a Provincial Government might not be anxious to direct, or its officers zealous to enforce, the collection of a tax "which brought no grist to the provincial mill." Although the Financial Relations Committee were instructed to report on the question for Bombay only, they felt that the grounds of the Bombay claim were common to all the provinces. They doubted if it would be possible permanently to exclude Provincial Governments from some form of direct taxation upon the industrial and commercial earnings of their people, and they recognised the natural anxiety of provinces to retain a share in a rapidly improving head of revenue. "But," they said, "so far as the income-tax is concerned, we see no reason to vary the scheme of the Report. We accept as valid the arguments given by its authors (paragraph 213); indeed, the second of these arguments is capable of further extension in the case of public companies with shareholders scattered over India and elsewhere. We advise, therefore, that the whole of the income-tax be credited to the Central Government. Their needs in the near future are likely to be quite as great, and to develop quite as rapidly, as those of the provinces, while we do not apprehend that the richer provinces, such as

Bombay, will be seriously handicapped in the administration of their own finances."[1]

The Financial Relations Committee thought that the case of general stamps was somewhat different from that of income-tax. They approached it, in the first instance, from the point of view of the poorer provinces. Some of these, it seemed clear to them, would start with little or no surplus revenue under the allocation of resources proposed in the Montagu-Chelmsford Report; and this would be both a misfortune in itself and at variance with what they believed to be the intention, if not the implied promise, of the Report. No remedy suggested itself except some extension of the schedule of provincial heads; for doles and temporary assistance would be inconsistent with the whole policy. In that view, and also because it would greatly facilitate the initial distribution of the central deficit, they advised that general stamps be made a provincial head throughout. In their opinion, the arguments in the Report for crediting it to the Central Government had not the same force as in the case of income-tax. They were not disposed to see grave disadvantage in different rates of stamp duty in different provinces, and any uniformity which might be considered essential could always be secured by central

[1] The Committee appended some figures which seemed to indicate that several of the provinces, and Bombay in particular, might look for reasonable elasticity in their revenues apart from income-tax.

legislation. Moreover, they held that in this part of the arrangements there was still the taint of a divided head, for general and judicial stamps were controlled by the same agency, and there was a good deal of miscellaneous work and outlay common to both. To make the whole of the stamp revenue provincial would secure a genuine and complete separation of resources; and the Committee expressed the hope that the reasons for this course would outweigh the only consideration on the other side, namely, the extent to which the deficit in the all-India budget would thereby be increased.

The Government of India's estimate of its deficit for the first year of the new constitution, namely, 6 crores, was accepted by the Financial Relations Committee. To this they added 4 crores for the loss of general stamps proposed by them to be made over to the provinces, and after making some adjustments regarding liabilities for pensions, leave allowances, and the military police in Burma, they arrived at 9·83 crores as the Imperial deficit under the proposed system of devolution. They saw no justification for the suggestion made in certain quarters that the Government of India should meet its own deficit by special taxation, at a time when the shortage in question was more than counterbalanced by the additional resources enjoyed by the Provincial Governments. They did not conceal from themselves the disadvantage in

ordinary circumstances of a system of provincial contributions, but they anticipated, that the Government of India would direct its financial policy towards reducing those contributions with reasonable rapidity, and their ultimate cessation. They recognised that it would be imprudent on the part of the Central Government to give any guarantee of the precise pace of reduction; but they thought that formal enunciation of the general policy would go some way towards allaying apprehensions. Such a policy would clearly be subject to the important reservation mentioned in the Report that the Central Government would remain empowered to levy special contributions, by way of temporary loan or otherwise, from the provinces in the event of a crisis.

In fixing the ratios in which the different provinces should contribute towards meeting the Central Government's deficit, the Financial Relations Committee felt themselves bound at the outset by a limiting consideration, namely, the obligation to leave each province with a reasonable working surplus,—a surplus calculated, as far as possible, with some relation to the general financial position of the province and the more imminent claims upon its resources. Looked at somewhat differently, the limit which the Committee imposed upon themselves was that in no case might a contribution be such as would force the province to embark on new taxation *ad hoc*, which

to their minds would be "an unthinkable sequel to a purely administrative rearrangement of abundant general resources." This limit, however, made it inevitable that the initial contributions should be in some measure arbitrary, dictated by the existing financial position of each province and not by any equitable standard.

The Financial Relations Committee observed that an examination of the basis of contributions which had been adopted in Montagu-Chelmsford Report, namely, realised surplus, had revealed some serious objections to it. This basis tended to stereotype inequalities of contribution where they existed, while by disclosing them it rendered them more difficult to justify. Moreover, the artificial and temporary nature of the basis could not be overlooked. It was too much determined by mere accidents of budgeting in spite of attempts to clear away abnormalities of expenditure. The best argument for the basis of realised surplus was that, when originally recommended, it recognised existing facts, that it appeared to leave all the provinces collectively with improved finances and each province with a surplus, and that it proceeded upon the principle of creating the minimum of financial disturbance in introducing the Reforms scheme. But the Committee thought that these advantages could be secured by another solution which was less open to criticism. If the recommendation of the Committee in regard to general

stamps was accepted, the net increase in the total income of all the provinces taken together would work out at 18·50 crores. These additional resources represented what the Central Government would lose and the provinces gain under the new scheme of redistribution. Some part of them, the Committee thought, the former might reasonably retain and the latter forego, so long as contributions to the Central Government remained necessary. They, therefore, proposed to assess the initial contributions on the increase of spending power in the provinces. This proposal had, in their opinion, the merit of proceeding on the lines of minimum disturbance of the financial position in each province and of leaving each province with a surplus.

As to the nature of this arrangement the Committee observed: "In the first place, it implies no judgment on the merits of the previous financial settlements with any province. The increase in revenues comes to the provinces as a windfall, or as a bye-product of a constitutional change. It is not due, as financial settlements have been in the past, to a consideration of the financial needs of individual provinces. It cannot properly be quoted as an admission of financial inequalities or as an act of tardy justice to the provinces that gain by it. Clearly, it has come about from political and not primarily from financial motives. Secondly, on this basis the system of contributions appears

in a less invidious light. The Central Government in the course of a political reconstruction gives to each of the Local Governments some, and to some Local Governments a very considerable, increase of spending power. Finding itself in a deficit as the result of this reconstruction, it withholds from each province a certain proportion of the increased resources which it is intended the province should eventually obtain.''

Having fixed the basis, the Committee proceeded to a calculation of the net additional revenues with which each province would be endowed by the new allocation of resources. They then considered the possibility of meeting the all-India deficit by an even rate on all the provincial figures. So far-reaching, however, was the disparity in the financial strength of the provinces that this arrangement would in some cases have caused hardship. They, therefore, found it necessary to consider each province on its merits. Although Behar and Orissa possessed large revenues, the Provincial Government was found to be the poorest in India. As it was still a new province, heavy initial expenditure lay in front of it, while there was a wholly abnormal want of elasticity about its revenues. The Committee, therefore, advised that no contribution should be levied from the province in the year 1921-22. The province of Burma was far behind India in administrative conveniences, and it was thought necessary that

a very substantial share of the additional revenues should be left free. The Committee, therefore, decided to fix on the province only about $6\frac{1}{2}$ per cent. of the total deficit. The cases of the Central Provinces and Assam also received special consideration at the hands of the Committee. Both these provinces had a small margin at the best of times, and their need for development was great. They were, therefore, asked to contribute roughly 40 per cent. of their windfall. The Committee recommended that the balance of the deficit be secured by a flat rate of about 60 per cent. on the new revenues of the remaining five provinces.

These initial contributions were not considered by the Financial Relations Committee as ideally equitable. In their opinion, to do equity between the provinces it was necessary that the total contribution of each to the central purse should be proportionate to its capacity to contribute. Unfortunately, however, the application of this principle presented many difficulties, and they did not pursue it any further. After surveying such statistical data as were available and after an enquiry into the circumstances of the different provinces, they recommended the following fixed ratios of standard contributions: Madras, 17 per cent.; Bombay, 13; Bengal, 19; United Provinces, 18; Punjab, 9; Burma, $6\frac{1}{2}$; Behar and Orissa, 10; Central Provinces, 5; Assam, $2\frac{1}{2}$.

These were the ratios which the provinces were to be called upon to contribute after an interval of seven years. The Committee recommended that the process of transition from the initial to the standard ratio should be continuous, beginning in the second year of contribution, and proceeding in six equal annual steps.

The question of financing the Provincial Loan Account did not present much difficulty. It was commonly agreed that, as a natural corollary of the Reforms, the provinces should finance their own loan transactions. The Governments of Bengal, the Punjab, the Central Provinces and Assam signified their willingness to take over the whole of their respective loan accounts on the first of April, 1921, and the Committee recommended that it should be arranged for them to do so. The other Governments, with the exception of Madras, expressed their desire to take over a portion of their loan accounts on the 1st April, 1921, and the remainder in instalments. Madras alone was unwilling to take over any part of its loan account. The Committee did not see any reason to make an exception in the case of Madras, and advised that the loan accounts of Bombay, the United Provinces, Burma, Behar and Orissa and Madras should be "funded," at a rate of interest calculated at the weighted average of the three rates of $3\frac{1}{2}$, $4\frac{1}{2}$ and 5 per cent. paid at that time on varying portions of the accounts. They further

recommended that periods of repayment should be fixed by future negotiations with the provinces within a maximum of twelve years.

The Report of the Committee on Financial Relations was forwarded to the Government of India. In regard to the proposal that general stamps should be converted into a provincial head of revenue the Government of India thought that it was a radical alteration in the allocation of revenues originally contemplated in the Reforms scheme. But it expressed its readiness to accept the proposal, although the surrender of this head of revenue, which had recently shown great capacity for expansion, involved a considerable sacrifice on the part of the Central Government. It admitted that the recommendation had in its favour the fact that it would get rid of the only divided head left in the budget under the original scheme, and from an administrative point of view it had its advantages, since general stamps could not be administered by the Central Government, while it could be, as it was then, administered by the same agency as judicial stamps. The Government of India observed further that the apprehensions expressed by the Madras Government regarding the inconveniences likely to result from different rates of stamp duties in different provinces did not appear to be shared by any other province. It agreed, however, with the Committee that there

were certain commercial transactions for which it was essential that the stamp duty should be uniform throughout India, and that it was necessary to take power to secure such uniformity, wherever desirable by central legislation. There was one further restriction which the Government of India desired to exercise on the powers of Provincial Governments in regard to general stamps. It proposed to retain the then existing system under which the whole of the receipts from unified stamps (used for postal as well as revenue purposes) were in the first instance credited to postal revenues and then fixed assignments were made to the non-postal general stamps revenues.[1] The retention of this system would mean that the provinces would not be empowered to make any changes in the stamp duties which were at that time collected by means of unified stamps. Although the stereotyping of the assignments implied that the income of a province derived from this particular kind of

[1] In the despatch of the Secretary of State, dated the 6th May, 1905, sanction was conveyed to the introduction of a system of unified stamps, which might be used in all cases in which one-anna adhesive stamps were required under the Indian Stamp Act, 1899. Following the method adopted in the United Kingdom it was decided at the time that the whole of the receipts from such unified stamps should, in the first instance, be credited to postal revenues and a credit was made to the non-postal revenues equivalent to the estimated loss due to the abolition of the one-anna revenue stamp. These fixed assignments had never been altered. As great convenience to the public had resulted from the system, the Government of India thought it necessary to continue it. *Vide Letter from the Government of India to the Rt. Hon. Edwin Montagu, dated the 24th June, 1920.*

stamps would never increase, the Government of India considered it essential not to disturb the system.

With regard to the proposal put forward by Bombay that each Provincial Government should receive half of the income-tax receipts collected within the province, the Government of India endorsed the arguments advanced in the Montagu-Chelmsford Report and the Report of the Financial Relations Committee against it. It also stated it as its emphatic opinion that income-tax must remain unequivocally an all-India source of revenue. It pointed out that it would have considerable difficulty in balancing the central budget with the contributions under the arrangements proposed by the Financial Relations Committee; and that it would be impossible for it to contemplate the surrender of any portion of this rapidly growing head of revenue. It was, the Government of India thought, the only revenue head in the budget from which a definitely increased yield could be immediately obtained by an enhancement of rates. It further observed that, apart from the effect the transfer of a share of income-tax to the provinces would have upon the finances of the Central Government, the transfer of half the revenue derived from this source and of any future increases under this expanding head would mean that the provincial contributions would continue for an indefinite period. As for the administration

of the tax, its assessment and collection, the Government of India agreed with the authors of the Joint Report that "if it should be found that the receipts fall off, it may be necessary to create an all-India agency for the collection of the tax, but this we should clearly prefer to retaining it as a divided head."

The Government of India did not consider it necessary to discuss the suggestion of the Bombay Government that land revenue should again become a divided head or the suggestion of the Madras Government that court-fee stamps should again become an all-India source of revenue, since both these taxes were to be administered by a purely provincial agency under the Reforms scheme.

On the question of the probable relative positions of the Central Government and the Provincial Governments, the Government of India expressed the opinion that the advantage to the provinces would, at the commencement of the Reforms era, be far greater than what was shown in the Report of the Financial Relations Committee. Its calculations tended to show that, if the figures for the budget of 1920-21 were taken, the income of the Provincial Governments would be 85·88 crores as against 76·61 crores estimated by the Committee, while the net gain to the provinces would rise from 8·67 crores to 10·48 crores. The Government of India thought that, even after

allowing for fluctuations, there would be a considerable addition to the estimated increase in the spending power of the provinces, and that the budget figures for 1921-22 were likely to show a corresponding improvement in favour of the provinces.

The Government of India refrained from making any comments on the criticisms put forward by different Provincial Governments regarding the methods adopted by the Financial Relations Committee in arriving at the distribution of the total contribution between the various provinces or on the complaint that some provinces had been unfairly dealt with as compared with others. It recognised, however, the difficulties likely to arise from a continuance of recriminations between the provinces regarding the comparative amounts that they should pay to the Central Government, and from this point of view alone it thought it desirable that the provincial contributions should be abolished as soon as possible. But while the Government of India was prepared to make a formal announcement that it would work its financial policy towards reducing, and ultimately abolishing, the provincial contributions, it declined to accept the proposals put forward by certain Provincial Governments that the period within which the contributions would cease should be definitely announced. Nor was it prepared to commit itself to definite periodical

reductions in the amount of the all-India deficit. The Government of India added: "Any reduction in the contribution will depend, firstly, on the extent to which we can expand our revenues and, secondly, on the purposes to which such expanded revenues should be applied. Amongst the competing claims to our revenues may be mentioned those of the public, who hold our floating and short-term debt, the Provincial Governments, and the paper currency reserve. It is obviously impossible, with so many uncertain factors, to make even an approximate estimate much less to give a definite guarantee of the pace at which or the period within which the contributions will be reduced or extinguished."

In respect of the recommendations of the Financial Relations Committee regarding the Provincial Loan Account, the Government of India accepted them in their entirety.

Meanwhile, the Government of India Act, 1919 had been passed. The Draft Rules framed under this Act were placed before a Joint Select Committee of Parliament. The Report of the Financial Relations Committee was also laid before this body. This Committee saw no reason to differ from the fundamental features of the proposals of the Meston Report, and they expressed themselves as definitely opposed to provincialising the taxation of income. But, in accordance with the suggestions made by the

Council of India, they expressed the opinion (*i*) that there should be granted to all provinces some share in the growth of revenue from taxation on incomes so far as that growth was attributable to an increase in the amount of income assessed,[1] and (*ii*) that in no case should the provincial contribution payable by any province be increased, but that the gradual reduction of the aggregate contribution should be the sole means of attaining the theoretical standards recommended by the Financial Relations Committee.[2] The Joint Select Committee stated that the acceptance of this latter proposal emphasised the intention that the contributions from the provinces to the Central Government should cease at the earliest possible moment. They attached great importance to the fulfilment of this intention, and expressed their conviction that the opposition which the Financial Relations Committee had evoked would be much diminished if it became possible for the Government of India to take steps to ensure the abolition of the contributions within a reasonably short period. The Committee desired also to add their recognition of the peculiar financial difficulties of the Presidency of Bengal, which they commended to the special consideration of the Government of India.

1 The manner in which this share was to be assessed and its extent were stated in the new Rule 15 which the Committee inserted.

2 The manner in which this was to be effected was expressed in the revised Rule 18.

The Joint Select Committee made various other alterations in the Draft Rules. Some of these deserve notice. In regard to Rules 27 and 28 and Schedule III, they considered it essential to draw a clear distinction between the powers of a Provincial Government to sanction and incur expenditure on transferred subjects and its powers in relation to expenditure on reserved subjects. They also thought it unnecessary and undesirable to prescribe by statutory rules the extent to which the Secretary of State in Council would be prepared to delegate his powers of control over expenditure on transferred subjects. In this connexion they observed that the clear intention of the Act of 1919 was that expenditure on transferred subjects should be within the exclusive control of the provincial legislatures and subject to no higher sanction than was reserved to the Governor by the Act. But the Committee thought some reservations were needed. It was essential, in their view, that the Secretary of State in Council should retain control over expenditure on transferred subjects, which was likely to affect the prospects or rights of the all-India services, and also over the purchase of stores in the United Kingdom. "But," they added, "subject to these limitations, ministers should be as free as possible from external control, and the control to be exercised over expenditure on transferred subjects, should be exercised by the provincial legislature, and by that body alone."

CHAPTER VII

CRITICISM OF THE PROPOSALS

The financial proposals of the Joint Report and the Report of the Financial Relations Committee met with a hostile reception in nearly every part of the country. The Government of Madras repeated the proposition already urged before the Committee that the aim of imperial finance should be to balance receipts and expenditure without any contributions from the provinces. If, however, it was found impossible to avoid a deficit at the outset except with the help of contributions, it was suggested that provision should be made for their extinction within a definite and short term of years. The Madras Government deprecated the proposal to make over to the provinces the revenue from non-judicial stamps on general grounds[1]

[1] "It is not likely," observed the Government of Madras, "that the mercantile community or the public generally would acquiesce in the Committee's opinion that the disadvantages of the varying rates of stamp duty are not grave. It is true that the revenue from judicial stamps is on somewhat the same footing as that from general stamps, and there is a superficial anomaly in treating one as imperial and the other as provincial; but if the principle is accepted that a head of revenue, which is or should be levied at a uniform rate throughout India, should be imperial, it would be more correct to

as well as on the ground that an enhancement of the imperial deficit would prolong the period during which the system of provincial contributions would continue. It protested against the percentages suggested for the original contributions and against the basis on which these had been calculated. The Government of Madras urged that the gradations from the initial to the standard contributions should be more rapid, so that the standard might be reached in three or four years instead of seven. It further suggested that the final standard contribution should be regarded as a payment due by the province to the Central Government, any amount which the province was called upon to pay in excess of that standard contribution being treated as a loan to be repaid with interest.

The Government of Madras controverted the view expressed by the Financial Relations Committee that, in the provinces that gained most, it would hardly be possible to spend in the first year the whole of the suddenly increased resources and that, if this were possible, it would be financially undesirable. It also demurred to the proposals of the Committee relating to the Provincial Loan Account. At a meeting of the Legislative Council of Madras resolutions were passed protest-

transfer the revenue from judicial stamps to imperial than to transfer that from general stamps to provincial." *Vide Letter from the Government of Madras to the Government of India, dated the 1st June, 1920.*

ing against the recommendation of the Financial Relations Committee regarding the levy on Madras.[1] Various public bodies in Madras also submitted representations urging a reconsideration of the recommendations of the Financial Relations Committee and claiming relief for the Presidency. Besides, public meetings were held to protest against these recommendations.

The Governor in Council of Bombay regarded the Meston proposals as "totally unacceptable." In his opinion, it was manifestly unjust that all taxation of the wealth of the well-to-do class in the shape of customs should go to the imperial revenues and that, in addition, all direct taxation

[1] The resolutions ran thus:—(*i*) "That no contribution should be levied from Local Governments except in cases of grave emergency;" (*ii*) "that if a contribution has to be levied to meet the deficit, the deficit should be wiped out in a fixed term of years. which should not exceed ten years, and that there should be a maximum amount beyond which contribution towards the deficit should not be claimed;" (*iii*) "that representations should be made to the Government of India that the contribution required from the Madras Government in the first year of the Reforms, namely, 348 lakhs, is excessive, and that the Madras Government will be unable to carry out several important schemes which have been hung up owing to financial stringency in the past;" (*iv*) "that representations be made to the Government of India for the retention of general stamps as an item of imperial revenue as general stamps are inappropriate as a provincial tax, and its transfer is likely to delay the complete wiping out of the deficit of the Government of India;" (*v*) "that in any case if any amount is levied in excess of the due proportion from the province of Madras it should be recovered from the provinces contributing less than their due proportion in such instalments and at such times as the Government of India may determine." *Vide Letter from the Government of Madras to the Government of India, dated the 1st June, 1920.*

of this class should be "sequestrated for imperial demands." He complained that the indirect contribution made by the province to the central exchequer had not been given adequate consideration. The Governor in Council was reluctant to accept the Committee's estimate of the net increase in spending power conceded to the Presidency under the proposed classification. Nor was he willing to accept the assumption as correct that there was a great capacity for future growth in the revenues made over to the province. He pointed out that the high expenditure of the Presidency was not entirely a matter of volition, but that it was necessitated in part at least by the geographical position of Bombay, with its two important ports, which imposed imperial liabilities upon its Government in addition to those which every Provincial Government had to discharge. He pointed out the patent absurdity of leaving the Government, with all the disabilities of a highly industrialised province, to finance their liabilities out of taxation of mostly small cultivators and of the labouring classes. The only possible solution, therefore, which could command general acceptance was to allow Bombay, as well as the other provinces, a half share in the income-tax, including the super-tax. "Theoretically," wrote the Chief Secretary to the Government of Bombay, "the canon of clean cut is desirable, but if theories are to dictate a solution of this problem, I am to

suggest that the simplest theory, which may appeal to the imagination of the statesman, would be to draw a sharp dividing line between direct and indirect taxation and assign wholly to Provincial the revenues directly derived in each area. Such a division would be wholly intelligible, and could be understood by all."[1]

In regard to the two considerations which had been held to weigh decisively against the grant to provincial revenues of a share in the income-tax, namely, (*i*) the necessity of maintaining a uniform rate of taxation and (*ii*) the fact that in the case of ramifying enterprises and of companies whose shareholders were scattered over several provinces the tax was not necessarily paid where the income was earned, the Government of Bombay insisted strongly that the first was not a vital objection. It had been accepted as negligible in the case of general stamps which had now been proposed to provincialise, and it had been further recognised that, where necessary, uniformity might be secured by imperial legislation. Precisely the same arguments, the Bombay Government urged, applied in the case of the income-tax. No provinces receiving a share in the income-tax would object to the rate of taxation being fixed by the Central Legislature and being determined by the requirements of the Government of India. It would

[1] *Letter from the Government of Bombay to the Government of India, dated the 3rd June, 1920.*

only be necessary for the provinces to adjust their other taxation according to their own requirements, after taking into account their anticipated share of the income-tax.

The second consideration related to a comparatively small proportion of the whole tax, and the objection was one which had been met in practice by every civilised government in the world. It could certainly be said of the bulk of the receipts that the income was earned in the province where the tax was paid. Besides, if provincial revenues benefited only to the extent of half the income-tax, half being left to imperial needs, the objection became purely negligible. "I am to deprecate," added the Chief Secretary, "most earnestly any slavish adherence to the attractive principle of a clean cut at the cost of arousing the keenest resentment from the public of Bombay at this critical time. The palliative offered by the Committee will inevitably be regarded as not worth a moment's consideration, and the inferences drawn by the Committee from figures which the public have not been allowed to examine will carry no weight at all. The only concession which can possibly meet the popular demand or indeed be effectively defended in the new provincial councils will be the assignment of a half share of the income-tax." [1]

[1] *Letter from the Government of Bombay to the Government of India, dated the 3rd June, 1920.*

The Bombay Chamber of Commerce protested against "the arbitrary allocation of revenues" suggested by the Meston Committee, and earnestly pressed for the treatment of income-tax as a provincial head of revenue. The Chamber was not impressed by the arguments advanced in the Joint Report and repeated by the Meston Committee that the tax could not be kept uniform if the revenue was provincialised and that the case of ramifying industries presented great difficulties. It pointed out that the first point had been met already by the latest proposals relating to general stamps, while the principle involved in the latter point was accepted in practice in every country in the world. Lastly, the Chamber emphasised the dangers of basing provincial finance mainly on collections from small cultivators and labouring classes, while the commercial section of the community contributed solely to the imperial purse. It, therefore, urged the necessity of a logical allocation of revenues on the basis of a distinction between direct and indirect taxes, and suggested that contributions towards meeting the imperial deficit should be fixed in simple proportion to provincial revenues rather than in proportions based on undisclosed calculations.[1]

The Indian Merchants' Chamber sent a telegram protesting emphatically against the recommendations of the Committee on the ground

[1] *Telegram to the Secretary of State, dated the 30th June, 1920.*

that they were "arbitrary and unsound," and were calculated to leave the Bombay Presidency without adequate heads of growing revenue. It suggested that the simplest and most logical course would be a clean cut between the Imperial and Provincial Governments by making all direct taxation provincial and all indirect taxation imperial. The Bombay Presidency Association expressed the view that the Meston proposals threatened to cripple the financial strength of the Presidency in the very beginning of the era of provincial autonomy. It regretted that the Committee did not adopt the only fair and reasonable proposal for apportionment of revenue between the Imperial and Provincial Governments, and urged that all direct heads of revenue should be assigned to the provinces. A memorial from the citizens of Bombay was submitted to the Secretary of State. "If provincial autonomy," said the memorialists, "is the object of the Reforms, provincial finance must be regulated on sound principles. The broad principle which must be followed, if the edifice is to endure, is that provincial finance should have a call on the resources of every class of the community. It would be the negation of sound finance to remove from the field of provincial taxation the resources of a large and important class." With regard to the statement in the Meston Committee's Report that the expenditure in Bombay had been on an unduly extravagant scale as

compared with the economy of the United Provinces and Madras, the memorialists pointed out that, if Bombay had been spending more, it had been paying at least proportionately more in taxation, and further, that it was a common experience that commercial, and particularly, industrial advance was always accompanied by an advance in the *per capita* cost of administration."[1] In conclusion, they submitted that justice and financial equity, as well as the necessity of ensuring a fair field, required that the income-tax, as the main expanding source of revenue, should be wholly allotted to provincial finance.

The Government of Bengal pointed out that the increased spending power accruing to the province from the Committee's recommendations was likely to amount to very little, as all special grants[2] from imperial to provincial revenues would cease. It emphasised the disproportionately small extent of the anticipated surplus in Bengal in comparison with those of the provinces of Madras (Rs. 2·28 crores), the United Provinces (Rs. 1·57 crores) and the Punjab (Rs. 1·14 crores), and it refused to accept the view that the requirements of Bengal were, in any sense, less than

[1] This memorial was adopted at a public meeting of the citizens of Bombay, held under the presidency of Sir Narayan Chandavarkar, on the 8th July, 1920.

[2] In the case of the Dacca University these amounted to no less than Rs. 62 lakhs.

those of the other provinces. If it was true of Madras and the United Provinces that economy had been strictly practised and considerable arrears of administrative progress were now due, the same was equally true of Bengal, in which it was admitted that the scale of expenditure at the time was low. By concentrating upon the revenue side of the account, observed the Government of Bengal, the authors of the Report had conveniently avoided the comparative assessment of provincial needs in the matter of outlay for development. It pointed out that, at an earlier stage before the Government of India and later before the Committee, the Provincial Government had strongly contested the adequacy of the estimate of normal expenditure as framed by the Government of India.

The Governor in Council laid stress upon the fact that the net additional revenue which the province would gain under the scheme of the Committee would rapidly disappear in the fulfilment of requirements, many of which were overdue, or at least could be clearly foreseen. As instances he mentioned the enhancement of the pay of the subordinate and ministerial services and the financing of the proposals of the Calcutta University Commission. The Government of Bengal said further that the obligation of leaving each province with a reasonable working surplus—which had been recognised by the

Committee—was likely to be fulfilled in the case of Bengal "only ostensibly." It added that the Committee's claim that the surplus had been calculated in proper relation to the more imminent demands upon its resources could not be sustained.[1]

The Government of Bengal challenged the impression, which at first sight might be derived from the figures in para. 17 of the Report, that the contribution of Bengal towards the imperial deficit, in comparison with the other major provinces, was disproportionately low. "If account be had," it observed, "to the sums drawn from the Presidency to the central exchequer under other heads noticeably those of customs and income-tax, the contrary is indeed the case."[2]

Emphatic protest was entered by the Government of Bengal against the suggestion of the Financial Relations Committee regarding the progressive enhancement of the contribution, for which it saw no justification whatsoever. The data put forward by the Committee were entirely of an indefinite character. It could only be imagined that, in proposing to raise the percentage of the Bengal contribution towards the total imperial deficit from the position of fourth lowest (among nine provinces) in the first year,

[1] *Letter from the Government of Bengal to the Government of India, dated the 2nd June, 1920.*

[2] *Ibid.*

to the highest in the seventh, the Committee foresaw in Bengal potentialities of a continuous and rapid development of revenue far in excess of the probable demands made upon it. It was pointed out that, in paragraph 27 of their Report the Meston Committee specifically claimed to have inquired into the relative taxable capacities of the provinces in the light of their agricultural and industrial wealth and of all other relevant incidents of their economic position, not only as they were at the moment but from the point of view also of the capacity of each province for expansion and development, agriculturally and industrially. "By this all-embracing test," urged the Governor in Council, "Bengal, at least, can only fairly be judged if its revenues are viewed as a whole. In other provinces, the profits of agricultural development will be largely reflected in enhanced land revenue; in a permanently settled province, the results of increased prosperity, either agricultural or industrial, will almost wholly be seen under customs and income-tax, with neither of which will the province in future be concerned."[1] As a matter of fact, in the opinion of the Government of Bengal, the possibilities of growth in the province would be reduced to a far narrower sphere than was calculated by the Meston Committee. It referred

[1] *Letter from the Government of Bengal to the Government of India, dated the 2nd June, 1920.*

to the burden of expenditure involved in the administration of a city like Calcutta, comparable to no other centre in India, except Bombay. It pointed out that the Committee had conceded that in Bengal the revenue was "inelastic." The circumstances of land revenue in Bengal were well known, and its average annual growth was at the utmost Rs. 1 lakh only, and it could not be more so long as the permanent settlement remained in force. Nor would the first fruit of the Reforms be a desirable thing if excise revenue were screwed up. The potentialities of forests in Bengal were limited, while the unexplored mineral resources were still to find. For the future, the Bengal Government observed, reliance would have to be placed almost entirely on stamps. Here the prospects were good, but they were not limitless, neither were they markedly superior to those of the other provinces. "If the main facts," it added, "are as stated, where, then, is this progressively rising assessment on the province to come from? It can only come from fresh taxation. But the Committee recognise that it would be 'unthinkable' so at least to fix the initial contributions as to force a province to embark on new taxation *ad hoc*."

If the anticipation of the rapid normal growth of existing heads of provincial revenues (still to be left as provincial) could be shown to be fallacious, the Government of Bengal observed, then

it could only be that the Committee felt that, failing the enhancement they suggested, Bengal would not contribute to the imperial exchequer in an adequate degree. This impression the Provincial Government had at the time of the enquiry made an apparently unsuccessful effort to dispel. The misapprehension was favoured by what, in the opinion of the Governor in Council, was the unfortunate omission in the Report to endeavour to ascertain with greater precision the contributions taken *as a whole* of each of the provinces. Under certain heads, *e.g.*, railways and post and telegraphs, this, no doubt, would be difficult, if not impossible, but there were other sources, such as income-tax (including super-tax), customs, and salt which bulked exceedingly largely in the figures and which had a vital bearing on the whole problem. Incidental mention of the fact was to be found in the Report (it being stated that consideration had been paid to this point), but the Governor in Council would have welcomed more precise information as to the figures to which weight had been attached.

Under the heads of income-tax, super-tax and customs, the revenue collected in Bengal and appropriated by the Government of India was far in excess of that derived from any other province, except Bombay. The Governor in Council considered it essential that this fact should be borne in mind. In fact, the taxable capacity of

this Presidency was concentrated largely in these sources; owing to historical causes, the local land revenue was not comparable with that collected in the temporarily-settled provinces. By the absorption of the profitable sources *in toto*, and the assessment of the so-called contribution on the remaining heads of revenue only, the sum paid was made to appear far smaller than it really was, leading constantly to deductions which were unfair to the province. This claim had been referred to in the Report of the Committee with the comment that it deserved recognition, though "often overstated and exaggerated." In regard to this matter the Government of Bengal observed: "Without entering upon such theories of taxation, the *practical* fact remains that, were these revenues not taken by the Central Government, they would be available for the Presidency, which, in that sense, is a loser. Neither is it altogether convincing to claim that Bengal has no title to benefit by the accident of geographical position. For one thing, the circumstances which have made Calcutta a leading financial centre are not merely geographical, and again they entail a corresponding disadvantage in the increased cost of administration in a huge city. But if the existence of Calcutta as a port is to be written off as a fortuitous circumstance, to benefit from which the Presidency has no claim, the same treatment should be accorded to the fortuitous natural

advantages of other provinces. For instance, the wonderful rivers of the Punjab afford extraordinary facilities for irrigation with corresponding growth of land revenue (on which, in fact, the recent financial prosperity of the province is largely founded); Burma and the Central Provinces contain extensive forests, and so on. The objection, in its turn, may easily be 'overstated.'"[1] But apart from this, though an exact calculation was impossible, it could rightly be concluded, from an analysis of the income-tax and customs receipts, that the major portion of such revenue was obtained from Bengal. Nor could the provincial claim to the greater part of the export duty on jute be questioned.

In conclusion, the Governor in Council strongly expressed the view that, looking to the extent of payment from Bengal under other heads to the Imperial Government, it was entirely unfair to assess the province at the highest level in respect of the standard contributions recommended by the Committee; and lodged a protest against the adoption of a course of action which was calculated "most gravely to prejudice the financial future of the province."[2]

Mr. (afterwards Sir) Surendranath Banerjea submitted a Note in which he observed that the

[1] *Letter from the Government of Bengal to the Government of India, dated the 2nd June, 1920.*

[2] *Ibid.*

indirect contribution of Bengal to the central exchequer was the largest of any of the provinces and that the inevitable result of the adoption of the Meston settlement would be the initiation of fresh taxation. This, in his opinion, was sure to strengthen the hands of the opponents of the Reforms. He, therefore, urged that the export duty on jute be made over to Bengal and that the ordinary income-tax be provincialised. This view was supported by all the public bodies of the province. The Indian Association of Calcutta strongly protested against the proposed financial arrangements, pointing out that the revenues allocated were insufficient to meet even the ordinary expenditure, thus necessitating fresh taxation at the very commencement of the Reforms. It urged provincialisation of the income-tax and the assignment of the jute export duty to Bengal. The Bengal Chamber of Commerce,—the leading European commercial association in India,—the British Indian Association,—a body representing the landholders of Bengal,—and the National Liberal League,—an institution which had recently been founded by the seceders from the Indian National Congress,—also made similar representations.

The Finance Committee of the Bengal Legislative Council submitted a Note on the Report of the Meston Committee in which they pointed out that, out of a total revenue (excluding the opium

and mint receipts) of Rs. 28½ crores raised in Bengal, the province was given only Rs. 7 crores and 29 lakhs, while Madras obtained 8 crores out of 20 crores, and the United Provinces 8·13 crores out of 13¾ crores. They emphasised the fact that enormous sums had been spent by the Government of India on irrigation works in the Punjab, the United Provinces, Madras and Bombay, but little expenditure had been incurred in Bengal for the purpose. To make land revenue and irrigation provincial heads of income and to keep income-tax and customs duties (including export duties) imperial was, they thought, to give a great advantage to certain provinces at the expense of others. The Finance Committee also hinted that the inequity of the financial arrangements was due to the fact that they had been moulded and influenced by representatives of Madras and the United Provinces. Finally, they urged that (*i*) in addition to general stamps, the receipts from income-tax, including the super-tax and the excess profits duty be made provincial in all provinces; (*ii*) that the export duty on jute be given to Bengal, because, properly speaking, it was not income from customs; (*iii*) that proper steps be taken for ascertaining the amount of indirect contribution paid by each province from other sources of revenue, so that the first Statutory Commission might be in a position to judge this matter properly and apportion correctly the share

of deficit to be paid by each province; and (*iv*) that for the present an equitable share of contribution for each province be fixed.[1]

The Bengal Legislative Council adopted a number of Resolutions condemning the financial arrangements recommended by the Meston Committee on the grounds that they were inequitable to Bengal, having been based on "an exaggerated and indefinite idea about the further taxable capacity of Bengal," and being "likely to jeopardise the successful working of the Reforms in the Presidency."[2]

The Government of the United Provinces took exception to the remark of the Meston Committee that in Madras and the United Provinces the windfall was so vast that it could not be employed profitably for several years. It pointed out that, while the increase of revenue was large, there were also large items of expenditure which had to be met. It also objected to the initial contribution of the province being fixed at so high a figure. While agreeing that the total contribution of a province to the central exchequer should

[1] *Vide Annexure to the Letter from the Government of Bengal to the Government of India, dated the 21st June, 1920.* This Note was signed by Sir Devaprasad Sarvadhikary, Mr. Surendranath Roy, Sir Provas Chandra Mitter, and Mr. Radha Charan Pal.

[2] These resolutions were moved by Mr. Surendranath Roy, and carried unanimously by the non-official members, the official members abstaining from voting. *Vide Proceedings of the Bengal Legislative Council, dated the 1st July, 1920.*

be calculated with reference to its indirect as well as its direct contribution, the Government of the United Provinces was unable to hold with the Committee that the capacity to contribute was its "taxable capacity." In its opinion, the first charge on the wealth of a province was the expenditure required to meet the needs of its population. Therefore, it thought that, in estimating the province's capacity to contribute on the basis of its taxable capacity, weight must be given not only to its nature, its liability to fluctuation (as a result, for instance, of famine), its possible expansion, and the elasticity of the resultant revenues, but also to the expenditure which must be provided out of those revenues to "meet the growing needs of a growing population."[1]

The Lieutenant-Governor of the Punjab accepted the initial, intermediate, and standard contributions fixed for the province. But he brought to the notice of the Government of India the view of the non-official members of the Finance Committee of the Legislative Council that the excess contributions, which would have to be paid until the standard percentage was reached, should be treated as a loan to be repaid ultimately by the provinces whose initial contributions were below the standard.

[1] *Letter from the Government of the United Provinces to the Government of India, dated the 31st May, 1920.*

The Lieutenant-Governor in Council of Behar and Orissa acquiesced in the recommendations of the Financial Relations Committee regarding income-tax and general stamps. He also regarded it as satisfactory that the recognition of the poverty of the Behar and Orissa Government had led the Committee to desist from demanding any initial contribution from it. But he recorded his emphatic protest against the proposed ultimate contribution. He added: "They propose that Behar and Orissa, whose poverty is recognised and whose resources are declared to be abnormally inelastic, should be required after seven years to bear 10 per cent. of the deficit then remaining, a proportion which is in excess of that to be required from the Punjab, which is to receive an immediate additional income of 289 lakhs, whose balances are full, and whose revenues move upwards with marked ease." The Lieutenant-Governor in Council regarded this proposal as "most inequitable." Finally, he drew attention to the necessity of providing the province with funds to meet the most urgent defects in its equipment.[1]

The Lieutenant-Governor of Burma gladly recognised that, so far as that province was concerned, the proposals had been framed on liberal

[1] *Letter from the Government of Behar and Orissa to the Government of India, dated the 29th May, 1920.*

and generous lines, and that the Financial Relations Committee had had due regard to the undeveloped condition of the province, the strictness of the terms of previous provincial settlements, and the large extent to which the province contributed to imperial revenues under such heads as customs and income-tax. He, however, hoped that the cost of the Frontier Battalions would be borne by the Government of India. Finally, he expressed the apprehension that the terms proposed to be made with Burma might be criticised by some of the Provincial Governments "as giving Burma favoured treatment at their expense." Such criticism, in his opinion, would be a short-sighted policy.[1]

[1] Sir Reginald Craddock wrote further: "While hoping that these provinces will not raise this objection, and that if they do raise it, it will not commend itself to the Government of India, I am to point out that there is one outstanding feature in respect of the proposals as they affect Burma, which is unlikely to attract the notice of other Local Governments in their examination of the proposals of Lord Meston's Committee as they affect themselves and other provinces. This feature is the inclusion of the proceeds of the *thathameda* and capitation taxes, which are peculiar in this province, in the head "land revenue," and therefore in the large balance left with the Government of Burma under the proposals of the Committee. It has been repeatedly pointed out by this Government that these taxes, amounting to some Rs. 90 lakhs, are essentially local in character, and though under the Committee's proposals the allocations of this amount between provincial and local funds has now become a matter of provincial direction, yet the inclusion of these essentially local taxes under the head of land revenue has a distinct bearing upon the statistical appearance of the Committee's proposals, and may give other local Governments the mistaken impression that Burma has been

The Chief Commissioner of Assam expressed his regret that a system of contributions from the Provincial Governments to the Central Government had been recommended, even for a limited period. He was of opinion that, by a revision of customs duties or otherwise, the Provincial Governments and the Central Government should each have been made self-supporting from the outset of the new regime. If, however, there was to be a system of contributions, the proposals put forward by the Committee were, in his opinion, open to fewer objections than any others which had so far been suggested. The Chief Commissioner was, however, far from being satisfied with the treatment accorded to Assam. He expressed the apprehension that a deficit would ensue at the outset, and observed that unless some way could be found whereby this deficit would be removed, the reformed administration of Assam would be "doomed to impotence and failure."[1]

The Chief Commissioner of the Central Provinces accepted the recommendations of the Financial Relations Committee, but urged that the Central Government should be under an

treated with greater generosity than has actually been the case."—*Letter from the Government of Burma to the Government of India, dated the 31st May, 1920.*

[1] *Letter from the Government of Assam to the Government of India, dated the 25th May, 1920.*

obligation so to regulate its finances as to provide for the gradual reduction of the deficit.

We thus find that the financial proposals of the Reform Scheme were subjected to very severe criticism by most of the Provincial Governments. They were condemned in the legislatures, in the press, and on the platform. These proposals created intense bitterness and gave rise to a sense of indignation rarely felt before on any question in the annals of British administration. The grounds of complaint, however, were different in the different provinces. Bengal and Bombay took strong exception to the system of allocation of resources under which their most promising source of revenue was to be taken away from them, while Madras and the United Provinces felt dissatisfied because they were called upon to make large contributions to the central exchequer out of the revenues allotted to them. The former criticism was eminently fair and just, but it was not heeded. The complaint of Madras and the United Provinces was not wholly illegitimate in the circumstances in which it was made, although the occasion for it arose from the inequitable distribution of resources. The question will be discussed in the tenth chapter.

CHAPTER VIII

THE REFORMED SYSTEM AND ITS WORKING

We come now to the provisions of the Government of India Act, 1919. This Act does not introduce any definite change in the financial powers of the Secretary of State or of the Council of India.[1] But Section 33 of the Act provides that the Secretary of State in Council may, by rule, regulate and restrict the exercise of his powers. This Act also vests the Secretary of State in Council with power to frame rules, many of

[1] Section 2(2) of the Government of India (Consolidation) Act runs thus: " In particular, the Secretary of State may, subject to the provisions of this Act [or rules made thereunder] superintend, direct and control all acts, operations and concerns which relate to the government or revenues of India, and all grants of salaries, gratuities and allowancee, and all other payments and charges, out of or on the revenues of India." The only change in this sub-section made by the Act of 1919 is the insertion of the words " or rules made thereunder."

Sec. 21 of the Consolidation Act runs as follows: "[Subject to the provisions of this Act, and rules made thereunder], the expenditure of the revenues of India, both in British India and elsewhere, shall be subject to the control of the Secretary of State in Council, and no grant or appropriation of any part of those revenues, or of any other property coming into the possession of the Secretary of State in Council by virtue of the Government of India Act, 1858, or this Act, shall be made without the concurrence of a majority of votes at a meeting of the Council of India." The only alteration in this section made by the Act of 1919 is the insertion of the words, " Subject to the provisions of the Act and the rules made thereunder."

which may affect the finances of the provinces in various directions. Further, it retains the Governor-General's power to withhold assent from Taxation Bills passed by the Provincial Legislative Councils.

Considerable power is, however, conferred by this Act on the provincial legislatures in respect of expenditure. It is provided that the estimated annual expenditure and revenue of a province should be laid in the form of a statement before the Council in each year, and the proposals of the Provincial Government for the appropriation of provincial revenues and other moneys should be submitted to the vote of the Council in the form of demands for grants. The Council possesses authority to assent, or refuse its assent, to a demand, or to reduce the amount therein referred to either by a reduction of the whole grant or by the omission or reduction of any of the items of expenditure of which the grant is composed. This procedure is, however, subject to two provisos. The first is that the Provincial Government has the power of restoring a refused or reduced demand, if it relates to a reserved subject, and if the Governor certifies that the expenditure provided for by the demand is essential to the discharge of his responsibilities for the subject. The second is that the Governor possesses the power, in cases of emergency, to authorise such expenditure as may, in his opinion, be necessary for

the safety or tranquillity of the province, or for the carrying on of a department. In pursuance of the procedure of the British House of Commons, it is laid down in the Act that no proposal for expenditure should be made except on the recommendation of the Governor, communicated to the Council.

Under the Act proposals for expenditure relating to the following heads are not required to be submitted to the Council:

(*i*) contribution payable by the Provincial Government to the Governor-General in Council;

(*ii*) interest and sinking fund charges on loans;

(*iii*) expenditure of which the amount is prescribed by or under any law;

(*iv*) salaries and pensions payable to or to the dependants of—(*a*) persons appointed by or with the approval of His Majesty or by the Secretary of State in Council; (*b*) judges of the High Court of the province; (*c*) the Advocate-General; (*d*) persons appointed before the 1st day of April, 1924, by the Governor-General in Council or by a Provincial Government to services or posts classified by rules under this Act as superior services and posts; and

(*v*) sums payable to any person who is or has been in the civil service of the Crown in India under any order of the Secretary of State in Council, or of a Governor, made upon an appeal

made to him in pursuance of rules made under this Act.

No provision exists in the Act for the passing of Appropriation Bills. In this respect, the budget procedure of Indian legislatures differs from that of the British Parliament. Taxation Bills are not differentiated from other Bills. A double assent, namely, that of the Governor-General as well as of the Governor, is needed to make these Bills effective. The Governor's power of preventing the enactment of measures,[1] as well as his power of affirmative legislation [2] by means of certification, is exercisable in the case of Taxation Bills as in that of other Bills.

[1] Section 11(4) runs thus: "Where any Bill has been introduced or is proposed to be introduced, or any amendment to a Bill is moved or proposed to be moved, the Governor may certify that the Bill or any clause of it or the amendment affects the safety or tranquillity of the province or any part of it or of another province, and may direct that no proceedings or no further proceedings shall be taken by the Council in relation to the Bill, clause or amendment, and effect shall be given to any such direction."

[2] Section 13(1) runs as follows: "Where a Governor's legislative council has refused leave to introduce, or has failed to pass in a form recommended by the Governor, any Bill relating to a reserved subject, the Governor may certify that the passage of the Bill is essential for the discharge of his responsibility for the subject, and thereupon the Bill shall, notwithstanding that the Council have not consented thereto, be deemed to have passed, and shall, on signature by the Governor, become an Act of the local legislature in the form of the Bill as originally introduced or proposed to be introduced in the Council or (as the case may be) in the form recommended to the Council by the Governor."

An important restriction is imposed by the Act on the financial powers of the provincial legislatures. The Legislative Council of a province is not, without the previous sanction of the Governor-General, competent to make or take into consideration any law (*a*) imposing or authorising the imposition of any new tax unless the tax is scheduled as exempted from this provision by rules made under the Act, or (*b*) affecting the public debt of India, or the customs duties, or any other tax or duty for the time being in force and imposed by the authority of the Governor-General in Council for the general purposes of the Government of India.

Under the provisions of the Act of 1919, a Provincial Government may, on behalf and in the name of the Secretary of State in Council, raise loans on the security of revenues allocated to it, and make proper assurances for that purpose. The conditions under which this power is exercisable are prescribed in the Rules.

Of the Rules framed under the Government of India Act, the Devolution Rules are the most important. The financial arrangements of the Reforms Scheme are provided for in detail in these Rules. Customs, cotton excise duties,[1] income-tax, salt duty, railway receipts, profits derived from opium, profits on coinage and currency, the net

[1] Cotton excise duties were suspended in December, 1925, and abolished in March, 1926.

gain derived from post and telegraphs, and receipts from central subjects are the main sources of central revenue. Land revenue, excise, stamps (both judicial and general), registration fees, irrigation receipts, and forest receipts are the chief heads of provincial revenue. In particular, the following sources of revenue are allocated to each of the Governors' provinces: (*a*) balances standing at the credit of the province; (*b*) receipts accruing in respect of provincial subjects; (*c*) a share (determined in the manner provided by rule 15) in the growth of revenue derived from income-tax collected in the province, so far as that growth is attributable to an increase in the amount of income assessed; (*d*) recoveries of loans and advances given by the Provincial Government and of interest paid on such loans; (*e*) payments made to the Provincial Government by the Governor-General in Council or by other Provincial Governments, either for services rendered or otherwise; (*f*) the proceeds of any taxes which may be lawfully imposed for provincial purposes; (*g*) the proceeds of any loans which may be lawfully raised for provincial purposes; and (*h*) any other sources which the Governor-General in Council may by order declare to be sources of provincial revenue.

In regard to (*c*), it should be observed that Devolution Rule 15 has undergone several modifications. Under the rule as it stood in 1921-22

the share of the Provincial Governments was calculated at 3 pies in each rupee brought under assessment. In consideration of this, each Provincial Government had to make an assignment to the Central Government equivalent to the amount which would have accrued to the Provincial Government in the year 1920-21 (after deducting the provincial share of the cost of special income-tax establishment in that year) if the pie-rate referred to above had not been applied in that year. The Provincial Government had also to bear 25 per cent. of the cost of the special income-tax establishments employed within the province. Under the revised Devolution Rule, the share of a Provincial Government is calculated at the rate of 3 pies in each rupee of the amount by which the assessed income of any year exceeds the assessed income of the year 1920-21. By a proviso to this rule, income assessed to super-tax is excluded from calculation. No portion of the cost of the income-tax establishment is now borne by a Provincial Government.

Devolution Rule 17 fixes a contribution of 983 lakhs for the year 1921-22 payable from the provinces to the Central Government, in the proportions recommended by the Financial Relations Committee. It also makes obligatory the payment of a similar contribution from the year 1922-23 onwards, subject to the condition that when the Governor-General in Council fixes a smaller total

amount, a reduction is to be made in the contributions of those provinces whose last previous annual contributions exceeded the proportion specified below of the smaller sum so fixed as the total contribution, and any reduction so made is to be proportionate to such excess: Madras, 17/90ths; Bombay, 13/90ths; Bengal, 19/90ths; United Provinces, 18/90ths; Punjab, 9/90ths; Burma, $6\frac{1}{2}$/90ths; Central Provinces, and Berar, 5/90ths; Assam, $2\frac{1}{2}$/90ths.[1]

The Devolution Rules provide that, in case of an emergency, any Provincial Government may be required by the Governor-General in Council, with the sanction of the Secretary of State, to pay a contribution in excess of the normal amount. The contribution to the Central Government is a first charge on the allocated revenues of a Provincial Government, and is payable in such instalments as the Governor-General in Council may prescribe.

The other matters in respect of which the provinces are related to the Government of India are also dealt with in the Devolution Rules. All moneys derived from provincial sources of revenue are to be paid into the public account, of which

[1] Behar and Orissa is not mentioned in the list. The reason is that in pursuance of the recommendation of the Parliamentary Joint Committee, this province is not required to make any contribution to the central exchequer.

A sub-rule was added in 1921 remitting the contribution payable by Bengal in the financial years, 1922-23, 1923-24 and 1924-25.

the Governor-General is the custodian, and credited to the province. The Governor-General in Council possesses the power, with the previous sanction of the Secretary of State in Council, to prescribe the procedure to be followed in the payment of moneys into, and the withdrawal, transfer and disbursements of moneys from, the public accounts, and for the custody of moneys standing in the account.

The Governor-General in Council also possesses the power, at any time when he considers this course to be essential in the financial interests of India as a whole, to require any Provincial Government so to regulate its programme of expenditure as not to reduce the balance at its credit in the public account below a stated figure. Subject to this power, the Provincial Governments are at liberty to draw on their balances, provided that sufficient notice is given of their intention to the Governor-General in Council. In case the Governor-General in Council debars a Provincial Government from drawing the full amount of which notice has been given, he is obliged to pay interest to the province.

In the matter of the Provincial Loan Account, it is laid down that any moneys which, on the 1st day of April, 1921, were owed to the Government of India should be treated as an advance to the Provincial Government from all-India revenues, and should carry interest. The interest is to be

payable on such dates as the Governor-General may fix; and in addition, the Provincial Government is to repay the principal amount in instalments so that the whole account may be cleared before the expiry of twelve years. Capital expenditure on irrigation financed from loan funds is also to be treated as an advance made to the province from central revenues, and interest is to be paid on it. In regard to the future, the Governor-General in Council is given the power at any time to make an advance to a Provincial Government on such terms as he may think fit to prescribe. The payment of interest on all such loans and advances are a charge on the allocated revenues of the province and are to have priority over all other charges, save only contributions payable to the Governor-General in Council. Another important provision is that each province is required to establish and maintain out of provincial revenues a Famine Insurance Fund,[1] which is to be utilised for the relief of famine or the construction of protective irrigation works or other works for the prevention of famine.

Some of the most important provisions of the Devolution Rules are those which relate to the

[1] Under Schedule IV of the Devolution Rules the different provinces were obliged to make every year the provision in the budget for this purpose. The schedule was altered in 1928, and now stands as follows: Madras, Rs. 3,00,000 ; Bombay, Rs. 12,00,000 ; Bengal, Rs. 2,00,000; United Provinces, Rs. 16,00,000; Punjab, Rs. 2,00,000 ; Behar and Orissa, Rs. 3,00,000 ; Central Provinces, Rs. 4,00,000.

internal arrangements in the Governor's provinces regarding taxation, borrowing, and the allocation of revenues between the two halves of the Government. The procedure laid down for this purpose is as follows: All proposals for raising taxation or for the borrowing of money on the revenues of a province are considered by the Governor with his Executive Council and Ministers sitting together, but the decision is thereafter to be arrived at by the Governor in Council or by the Governor and Ministers, according as the proposal originated with the Governor in Council or the Governor acting on the advice of the Ministers. The framing of proposals for expenditure in regard to the reserved and transferred subjects is a matter of agreement between the two parts of the administration. But if the Governor finds at the time of the preparation of the budget that there is no hope of agreement, he may allocate the revenues and balances of the province between reserved and transferred departments, by specifying the fractional proportions to be assigned to each of the departments. The Governor may, for this purpose, obtain the assistance of an expert appointed by the Governor-General.

Such allocation remains in force for a period specified in the order, which must not be less than the duration of the then existing Legislative Council, and must not exceed by more than one year the duration thereof. If, however, the Executive

Council and the Ministers so desire, the Governor may at any time revoke the order of allocation and make such allocation as may be agreed upon between them. In case an increase of revenue accrues during the period of allocation on account of the imposition of fresh taxation, such increase, unless the legislature otherwise directs, is allocated in aid of that part of the Government by which the taxation was initiated. If at the time of the preparation of the budget no agreement or allocation has been arrived at, the budget is to be prepared on the basis of the aggregate grants respectively provided for the reserved and transferred subjects in the budget of the year about to expire.

The Devolution Rules provide for the establishment of a Finance Department in each of the Governor's provinces. This Department is under the control of a member of the Executive Council. Immediately subordinate to him is a Financial Secretary. If the Ministers so desire, the Governor has also to appoint, after consultation with the Ministers, a Financial Adviser, whose duty it is to assist the Ministers in the preparation of proposals for expenditure, and generally to advise the Ministers in matters relating to finance. The Finance Department may delegate to the Financial Adviser many of its functions. The Finance Department is charged with the duty of dealing with all matters concerning (*a*) loans, (*b*) the Famine Insurance Fund, (*c*) increase or

reduction of taxation, (*d*) borrowing, (*e*) keeping of proper accounts, and (*f*) balances. It is also the duty of the Department to prepare the statement of estimated revenue and expenditure which is laid before the Legislative Council in each year, as also any supplementary estimates or demands for excess grants which may be submitted to the vote of the Council.

For the purpose of such preparation, it obtains from the departments concerned material on which to base estimates. It has power to examine and advise on all schemes of new expenditure, and may decline to provide in the estimates for any scheme which has not been so examined. It is further its duty to lay the audit and appropriation reports before the Committee on Public Accounts and to bring to the notice of the Committee all financial irregularities. The Finance Department possesses the power to sanction any reappropriation within a grant from one major, minor, or subordinate head to another, and when a Member of the Executive Council or a Minister exercises his power of reappropriation within a grant between subordinate heads, such fact has immediately to be communicated to the Finance Department. Lastly, without previous reference to, or consultation with, the Finance Department, no expenditure can be incurred in excess of the estimate on any of the heads excluded from the vote of the Legislative Council, no

office may be added to, or withdrawn from, the public service, no allowance or special pay may be sanctioned, no grant of land or assignment of land revenue or concession of mineral or forest rights, etc., may be made, and no proposal involving abandonment of revenue may be submitted to the Provincial Government or the Legislative Council.

When the agency of the Governor in Council of a province is employed by the Government of India, the cost of the agency establishment is met out of central revenues. In the case of a joint establishment, the cost is distributed by agreement; but if there is no agreement the cost is divided in such manner as may be determined by the Secretary of State in Council.

Under the Devolution Rules, the financial powers of superintendence, direction and control vested in the Governor-General in Council are strictly limited in relation to transferred subjects.[1] By a separate set of rules the financial as well as other powers of the Secretary of State are also considerably restricted so far as transferred subjects are concerned.[2] But under Schedule 111

[1] These powers are to be exercised only for the following purposes, namely, (1) to safeguard the administration of central subjects; (2) to decide questions arising between two provinces in case of a failure to arrive at an agreement; (3) to safeguard the due exercise of powers and duties vested in or imposed on the Governor-General in Council in connexion with the duties of the High Commissioner for India, the raising of loans, the position and prospects of the higher civil services, and the rules made by the Secretary of State in Council.

[2] Under the Relaxation of Powers Rules, the powers of the

of the Devolution Rules the previous sanction of the Secretary of State in Council is necessary to the creation or abolition of posts in the cadre of an all-India service, or to the increase or reduction in salaries drawn by members of all-India services, or to the creation of posts carrying large salaries, or to the grant of allowances, pensions, or gratuities which are not admissible under the rules, or to any expenditure on the purchase of imported stores or stationery.

Under the Scheduled Taxes Rules, the Legislative Council of a province is empowered, to make laws, without the previous sanction of the Governor-General, imposing for the purposes of the Provincial Government, any of the following taxes: (1) a tax on land put to uses other than agricultural; (2) a tax on succession or acquisition by survivorship in a joint family; (3) a tax on betting or gambling; (4) a tax on advertisements; (5) a tax on amusements; (6) a tax on any specified luxury; (7) a registration fee;

Secretary of State and of the Secretary of State in Council are in relation to transferred subjects, to be exercised only for the following purposes, namely, (1) to safeguard the administration of central subjects; (2) to decide questions arising between two provinces, in case of a failure to arrive at an agreement; (3) to safeguard imperial interests; (4) to determine the position of the Government of India in respect of questions arising between India and other parts of the British Empire; and (5) to safeguard the exercise and performance of powers and duties of the Secretary of State or the Secretary of State in Council in connexion with the duties of the High Commissioner for India, borrowing by Provincial Governments, and safeguarding the position of the higher civil services, or any rules made by the Secretary of State in Council.

(8) a stamp duty other than duties of which the amount is fixed by central legislation.

The Legislative Council of a province may also, without the previous sanction of the Governor-General, make any law imposing, or authorising any local authority to impose, any of the following taxes,[1] namely, (1) a toll; (2) a tax on land or land values; (3) a tax on buildings; (4) a tax on vehicles or boats; (5) a tax on animals; (6) a tax on menials and domestic servants; (7) an octroi; (8) a terminal tax on goods imported into, or exported from, a local area; (9) a tax on trades, professions and callings; (10) a tax on private markets; (11) a tax imposed in return for services rendered, such as (*a*) a water rate, (*b*) a lighting rate, (*c*) a scavenging, sanitary or sewage rate, (*d*) a drainage tax, and (*e*) fees for the use of markets and other public conveyances.[2]

The procedure adopted in connexion with the consideration of the annual budget by a Legislative Council is provided for by the rules of business and standing orders in every province. These rules and standing orders differ, to some extent, in respect of details, but the general principles underlying them are practically the same in all the provinces. The

[1] The word 'tax' here includes a cess, rate, duty, or fee.

[2] The Governor-General in Council has power, at any time, to make any addition to the taxes mentioned in this and the previous paragraph.

more important of these may be mentioned here. A separate demand is ordinarily made in respect of the grant proposed for each department of the Government. Demands affecting reserved and transferred subjects are, as far as possible, kept distinct. Each demand contains a statement of the total grant proposed as well as a statement of the detailed estimate under each grant, divided into items. No discussion of the budget takes place on the day on which it is presented. The budget is dealt with by a provincial Council in two stages, namely, (*i*) a general discussion, and (*ii*) the voting of demands for grants. At the former stage, the members of the Council are at liberty to discuss the budget as a whole or any question of principle involved therein; but no motion may be moved, nor may the budget be submitted to the vote of the Council. The members of the Executive Council and Ministers reply to the criticisms levelled against their respective departments, and the Finance Member has a general right of reply at the end of the discussion. A time-limit for speeches is generally prescribed.

A number of days is allotted by the Governor for the discussion of the demands of the Provincial Government for grants. A time-limit is also prescribed for the discussion of any one demand. Motions may be moved at this stage to omit or reduce any grant or any item in any grant, but not

to increase or alter the destination of a grant. As soon as the maximum time-limit for discussion of any item is reached, the President puts every question necessary to dispose of the demand under discussion. Motions for the reduction of the grant as a whole are taken up after all motions for the omission or reduction of definite items have been discussed and disposed of. On the last of the allotted days the President puts every question necessary to dispose of all the outstanding matters in connexion with the demands for grants.

If the Provincial Government or the Governor exercises the power conferred by Section 72D (2), provisos (*a*) and (*b*), of the Government of India Act in regard to the demands refused or reduced by the Council, the Finance Member lays on the table of the Council a statement showing the action taken by the Government, together, in the case of action under Section 72D (2), proviso (*a*), with a copy of the certificate granted by the Governor; but no motion may be made in regard to such action.

When money has been spent on any service for which the vote of the Council is necessary during any financial year in excess of the amount granted for that service and for that year, a demand for the excess is presented to the Council by the Finance Member. An estimate may be presented to the Council for a supplementary or additional grant when (*i*) the amount voted in the

budget of a grant is found to be insufficient for the purposes of the current year ; or (*ii*) a need arises during the current year for expenditure for which the vote of the Council is necessary upon some new service not contemplated in the budget for that year.[1] An estimate may also be presented to the Council for an additional or supplementary grant in respect of any demand to which the Council has previously refused its assent, or the amount of which the Council has reduced either by a reduction of the whole grant or by the omission or reduction of any of the items of expenditure of which the grant is composed. Excess grants and supplementary or additional estimates are dealt with in the same way by the Council as if they were demands for grants.

A Committee on Public Accounts is constituted for the purpose of dealing with the audit and appropriation accounts of the province and such other matters as the Finance Department may refer to the Committee. The Committee on Public Accounts consists of such number of members as the Governor directs ; but not less than two-thirds are elected by the non-official members of the Council, and the remaining members are nominated by the Governor. The Finance

[1] When, however, funds to meet proposed expenditure on a new service can be made available by re-appropriation, a demand for the grant of a token sum may be submitted to the vote of the Council, and if the Council assents to the demand, funds may be made so available.

Member is the Chairman of this Committee. In scrutinising the audit and appropriation accounts of the province, it is laid down in the rules as the duty of the Committee to satisfy itself that the money voted by the Council has been spent within the scope of the demand granted by the Council. It is also the duty of the Committee to bring to the notice of the Legislative Council (*i*) every re-appropriation from one grant to another ; (*ii*) every re-appropriation within a grant which is not made in accordance with the rules regulating the functions of the Finance Department, or which has the effect of increasing the expenditure on an item, the provision for which has been specifically reduced by a vote of the Council ; and (*iii*) all expenditure which the Finance Department has requested should be brought to the notice of the Council.

The reports of the Committee on the audit and appropriation accounts are placed before the Legislative Council. The members of the Council may discuss these reports. As a matter of fact, however, discussions rarely take place on these reports. The rules of business and standing orders of some of the provinces provide for the appointment of a Standing Finance Committee. Although such a body has no statutory functions, it does a considerable amount of useful work in the way of examining budget proposals. It is a pity that no such Committee has been appointed in Bengal

since the inauguration of the Reforms, though a Committee of this sort was in existence in the pre-Reform period.

One of the most important provisions of the Government of India Act, 1919, is that which relates to financial control. A sound system of finance, whether provincial or central, cannot exist without an efficient and independent system of audit. Sec. 39 of the Act gives the Auditor-General, who is the administrative head of the audit department, a statutory position. He is appointed by the Secretary of State in Council, and holds office during the King's pleasure. The position occupied by the Auditor-General is thus similar to that of a High Court Judge in India. He is in no way under the control of the Governor-General in Council or of the Provincial Governments. Under the rules framed by the Secretary of State in Council, he draws fixed pay; and, on vacating office, is not eligible to any other post under the Crown in India.

The Auditor-General is the final audit authority in India, and is responsible for the efficiency of the audit of expenditure in India from the revenues of the country, whether central or provincial. He possesses power (*i*) to inspect, either personally or through an audit officer, any Government office of accounts in India, (*ii*) to arrange for test audit in any Government office of accounts, and (*iii*) subject to any orders of the

Secretary of State, to frame rules in all matters pertaining to audit. In regard to provincial finance, it is his duty to bring to the notice of the Provincial Government any breach of the financial canons. He also compiles the Finance and Revenue Accounts of India and for this purpose he may require any Government officer to furnish any information.

The passing of the Act of 1919 marks an almost complete departure from the financial system which preceded it. Not only have the Provincial Governments acquired a statutory financial position, but they have obtained a substantial measure of financial autonomy. An examination of the Act and the rules framed thereunder, however, reveals various restrictions [1] and limitations on the powers of the provinces. We now proceed to discuss the more

[1] As Mr. J. E. C. Jukes points out, the restrictions upon financial autonomy fall into two main classes. He says: "The first class is that which definitely and finally prohibits specified actions unless certain conditions are fulfilled. Thus, a loan may not be raised except for certain specified purposes, and no authority at all has power to relax this rule while it remains in force. The second class of restrictions does not prohibit an action but requires the sanction of higher authority to it before it can be performed. This class is a definite restriction upon autonomy, seeing that it deliberately sets up an authority higher than the local government. The existence of the first class, on the other hand, is not inconsistent with autonomy, except on the ground that it is enacted by an authority outside the local government." *Vide Appendix No. 5 to the Report of the Reforms Enquiry Committee.*

important of these. The continuance of the statutory powers vested in the Secretary of State in Council stands in the way of the development of a sense of financial responsibility in the provinces. It is true that there is provision for a relaxation of these powers by means of rules framed under Section 19A. But this provision is merely permissive, and the degree of relaxation depends very largely upon the will of the Secretary of State, who has a very large share in the framing of these rules. As a matter of fact, the Secretary of State retains almost complete control over the finances of the reserved subjects, while the power, which is exercised by him under Devolution Rule 27 and Schedule 111 to these Devolution Rules, detracts very largely from the financial discretion of the Provincial Governments even in regard to the transferred subjects. The authority possessed by the Secretary of State in respect of the appointments made to the All-India Services even in the transferred departments and the fixing of their salaries also serves largely to curtail the financial powers of the Provincial Governments. Another restriction is to be found in the matter of borrowing, as the Secretary of State possesses the power to make rules and to refuse sanction to a loan proposed to be floated in England. It is also an anomaly that provincial loans should still be raised on behalf and in the name of the Secretary of State in Council, although the security is furnished by the provincial

revenues. The rules framed by the Secretary of State to regulate expenditure on imported stores constitute another restriction on the financial powers of the provincial governments. If provincial autonomy in the financial sphere is to be real, all these limitations must be withdrawn.

The Governor-General in Council retains full control over all financial matters relating to the reserved subjects. He also possesses some powers in relation to transferred subjects. For instance, Rule 2 of Schedule III to the Devolution Rules gives the Governor-General in Council the power to recommend applications of Provincial Governments relating to certain posts for the sanction of the Secretary of State, and even to sanction such posts on behalf of the Secretary of State. Besides, the fact that he is not only the custodian of the provincial public account but is responsible for the ways and means of the provinces has made it necessary to invest him with large powers in matters relating to the withdrawal of provincial balances. It may be mentioned in this connexion that the Government of the Punjab suggested in 1924 that, with the adoption of a system of separate accounts with a central bank, it would be possible to justify the grant to Provincial Governments of a freer hand in the regulation of their ways and means. But the Reforms Enquiry Committee expressed the view that further advance towards autonomy in provincial finances would

depend upon the separation of provincial balances from the balances of the Government of India. Such a step would give to the Provincial Governments far larger resources than they enjoy under the existing system.[1] These would also make possible the maintenance of larger balances than is found practicable at present. This change could, as was pointed out by Mr. Jukes in the Memorandum submitted by him to the Reforms Enquiry Committee, be effected without grave administrative inconvenience or serious expense to either the Central Government or the Provincial Governments.

But a change of this kind must inevitably be accompanied by the separation of accounts from audit. This matter is now under the consideration of the Government of India. When the separation is effected, it will be necessary for the Provincial

[1] *Vide Memorandum by J. E. C. Jukes, submitted to the Reforms Enquiry Committee.* He says: " Very considerable sums of money are deposited for short periods with the Government. Among these may be mentioned such deposits of various kinds and the balances of municipalities and other local bodies. The sums so deposited are eventually withdrawn, but they represent a large and practically constant balance in the Government account. The majority of these deposits accrues in connexion with the administration of provincial subjects, but the local Governments have not hitherto enjoyed the use of them... If the local Governments assume the custody of their own balances, they will acquire with it a right to the use of that portion of the balance of deposits which has accrued in connexion with the administration of provincial subjects. The sums involved will in every case be far more than sufficient to place the provinces in funds to meet their day to day requirements."

Governments to compile their own accounts, but the audit of accounts will remain a central subject under the control of the Auditor-General.

In the matter of borrowing, the control of the Governor-General in Council is fairly tight. The Reforms Enquiry Committee suggested that some relaxation of this control might be possible, though they did not consider that, in the existing circumstances of India, the relaxation could be complete. There are, it may be admitted, practical difficulties in the way of relaxing this control. The loan market being limited, the competition of two authorities seeking to raise loans in the same market may tend to raise the rates of interest. It is in many ways advantageous to leave loan operations in the hands of one authority. But when the Provincial Governments become responsible for their own ways and means, it will be necessary to empower them to take short-term advances from the Imperial Bank.

The restrictions on the powers of Provincial Governments in regard to expenditure are much less in the case of transferred departments than in the case of reserved departments. With a further advance in constitutional development, these restrictions should cease in respect of both classes of cases, and all services should be placed under the control of the Provincial Governments. Power should be given to the provinces to change the Fundamental Rules which govern the conditions of service in Indian provinces.

The powers of taxation at present possessed by the Provincial Governments are very limited. Whenever a Provincial Government desires to levy a tax which is not a scheduled tax, the sanction of the Governor-General in Council has to be obtained. It must be admitted that there is a real difficulty in removing altogether this restriction on the taxing powers of a Provincial Government. If the field of central taxation is encroached upon by the provinces, the Government of India may find it difficult to increase its resources in case of a financial necessity. But an enlargement of the schedule of provincial taxes may be made without inflicting any substantial injury on the Central Government.

A great deal of criticism has been levelled against the Finance Departments of the different provinces. It has been asserted that they have proved a clog to the wheel of Indian progress and an impediment to the success of the Reforms. One legitimate criticism is that the Finance Department in a province is not common to both halves of the Government and independent of either, but is a reserved department. The Finance Member must be a member of the Executive Council; no Minister is entitled to occupy this position, however capable he may be. As was pointed out in the Minority Report of the Reforms Enquiry Committee, there is no force in the argument put forward in defence of this rule that trained men are required to fill the office, for many persons have

held the position who have not had any training in the theory and practice of finance. Complaints have also been made that the Finance Member has often looked more to the interests of the reserved departments than to the interests of the transferred departments. This, however, is denied by some members of Executive Councils. The majority of the Reforms Enquiry Committee suggested that the Finance Member should not have charge of any of the large spending departments. But this suggestion was regarded by the minority as a "costly remedy," which was not "a real and full remedy." Another suggestion was made before the Reforms Enquiry Committee that the Finance Member should be neither a member of the Executive Council nor a Minister; this was considered impracticable. The best remedy would obviously be to remove the dyarchic system and vest the control of the Finance Department in a Minister.

But a more serious charge is that the Finance Department assumes functions which were not in the contemplation of those who urged its formation. Their duty was intended to be to "watch and advise," but not to dictate or veto policy. The power vested in the Finance Department was not intended to be an over-riding power. But the power to decline to provide in the estimates any new scheme which has not been examined by the Finance Department is really an over-riding power.

Besides, the examination of schemes has often been different from what was intended by the authors of the Reforms. Many of the Ministers and ex-Ministers gave evidence before the Reforms Enquiry Committee to the effect that the Finance Department, in examining proposals of other departments, not only considered the financial point of view but also considered the policy of the proposals. The majority of the Muddiman Committee pointed out that, when a report from the Finance Department on an expenditure proposal was received by a transferred department, the Minister-in-charge was entitled to overrule the Finance Department unless the latter had definitely required that the Minister should refer the case to the Governor. This, however, was regarded by the minority as "an incomplete and a theoretical description of the position." The majority expressed the view that a control of the nature provided in the Devolution Rules was necessary, and did not consider any modification of the rule desirable. The minority, however, regarded the system as open to grave objection.

The general power conferred by Rule 38 on the Finance Department to sanction re-appropriation from one major, minor or subordinate head to another is a very important power. There seems to be no reason why this power should not be vested in the head of the spending department concerned. Such an officer is in a better position

to understand the needs of the different branches of his department than the Finance Department. As a safeguard against future commitments, it may be provided that re-appropriation must not be of a character which involves additional financial responsibilities for the future.

The peculiar position occupied by the Finance Department in a province leads us to consider whether the present system of allocation of funds between the reserved and transferred departments is a suitable one or not. Under this system, in case of failure of the two halves of the Government to come to an agreement, the Governor possesses the power to allocate the resources. In actual practice, however, it has not been found necessary in any province to apportion the available funds in this manner. It is possible that this has been due to the fact that surplus funds were, generally speaking, not available. When the Government of India made the proposal of a joint purse in its Fourth Despatch on the Constitutional Reforms, it did not secure support from Indian political opinion. But the evidence tendered to the Reforms Enquiry Committee seemed to indicate that there had been some change in this respect. The Government of Madras, a Member of Council and some ex-Ministers from Bengal, the President of the Legislative Council in Behar and Orissa, and a Minister in Assam suggested that the system of a separate purse should be established. The

majority of the Reforms Enquiry Committee expressed the opinion that such a separation must introduce complications, and protested against a re-opening of the question. The minority took the view that this proposal, instead of mitigating the evils of the present financial system, was likely to aggravate them. The only cure, they thought, was to be found "in the replacement of the dyarchical by a unitary and responsible provincial Government."[1] This seems to be the correct view of the matter.

Although there was provision in the Devolution Rules as originally framed for a Joint Financial Secretary to the Finance Department, no appointment had been made in any province before the time of the Muddiman Committee's enquiry. Perhaps this was due to a misapprehension of the functions which it was intended that this officer should perform.[2] The majority of the Reforms Enquiry Committee thought that such an officer would frequently be able to afford very valuable assistance to the Ministers, particularly when funds were available for development on the transferred side. Such a financial adviser, they said, would doubtless receive delegated

[1] *Minority Report of the Reforms Enquiry Committee, Ch. VI.*

[2] Mr. S. M. Chitnavis, at one time Minister in the Central Provinces, said that such an officer might be looked upon as a spy, and it was no wonder that in no province did the Ministers press for this appointment.

powers from the Finance Member ; but the main value to the Minister would be in advising them in the preparation of their proposals for expenditure so as to secure that they were not likely to suffer from technical objections which might be raised by the Finance Department. The minority, however, held the view that the appointment of a Joint Secretary would not solve any of the difficulties of the existing system. They further expressed the opinion that, if advantage had been taken of this provision by the Ministers, it would only have produced administrative difficulties and friction.

The change which was subsequently made in Devolution Rule 36(1) was more a change of form than of substance. The position of the Financial Adviser seems to be a very anomalous one. It is not clear whether he is subordinate to the Finance Member or is a wholly independent officer. Besides, the provision relating to the delegation of functions by the Finance Department to the Financial Adviser is merely permissive. If the new rule be interpreted liberally it may help to reduce, to some extent, the friction between the Finance Department and the Ministers, but it is no real remedy for the unsatisfactory state of things which prevails at present.

The powers enjoyed at present by the Legislative Council of a province are extremely restricted. The effect of the exclusion of the salaries and

pensions payable to a large section of officers of the Government and their dependents from the vote of the Council is not only objectionable in principle, but very undesirable from the practical standpoint. Nor is there any reason why interest and sinking fund charges on loans should form non-votable items in the budget of a province, in view of the fact that provincial revenues are now responsible for such payments. The power of restoration further limits the authority of the Legislative Council. This power was intended to be used only in special circumstances; but, as a matter of fact, it has been exercised so often since the inauguration of the reforms that it has come to be regarded as an ordinary power. The financial authority of the Legislative Council is still further curtailed by the emergency power of expenditure vested in the Governor. This power is very wide, inasmuch as it may be exercised, not only for maintaining peace and order in the province, but for carrying on the ordinary work of administration. If the Legislative Council is to feel a sense of real financial responsibility, it is essential that these restrictions and limitations should be removed. It would also be desirable to provide for the passing of annual Appropriation Acts in the provinces as is done in Great Britain.

The main function of the Public Accounts Committee is to ensure the accountability of the executive to the legislature. This function

unfortunately, is not properly exercised at present. One reason for this is to be found in the defective constitution of the Committee. It would be eminently desirable that in future the Public Accounts Committee should consist entirely of members elected by the legislature, and that the Chairman should be a non-official member as is the practice in the House of Commons. Definite rules should be made and separate dates set apart for the discussion of the reports of the Public Accounts Committee in the Legislative Council.

A Finance Committee should also be established in every province and vested with statutory powers. This Committee should consist entirely of elected members, and meet under the Chairmanship of the Finance Member or Minister. The main duty of this Committee ought to be to scrutinise all new items of expenditure. Members of this Committee should also be given power to suggest for inclusion in the budget items not included in the draft prepared by the Finance Member. All supplementary estimates should also be placed before the Finance Committee before presentation to the Legislative Council.

CHAPTER IX

THE FINANCIAL POSITIONS OF THE PROVINCES

The first two years of the reformed system of administration were for Madras years of financial difficulty. The Government of the province, however, did its best to make its two ends meet. The Standing Finance Committee of the Legislative Council was entrusted with the duty of retrenching expenditure, and it submitted its proposals from time to time. Its recommendations included both reduction of expenditure and augmentation of revenues. Most of these recommendations were accepted by the Government, either wholly or in part. The revenue for the year 1921-22, after deduction of a contribution to the Central Government and some adjustments amounting altogether to Rs. 3,83,81,000, was Rs. 11,74,88,517, while the expenditure was Rs. 12,80,24,119.

In the latter half of the year 1922-23, a Retrenchment Committee was appointed, whose recommendations resulted in an immediate saving of 18 lakhs of rupees, and were expected to secure a further saving of 18 lakhs when all the suggested measures had attained full realisation. The

gross provincial revenue of the year exceeded that of 1921-22. A considerable part of this increase was due to the raising of the stamp duties and court fees. The financial situation during the year continued to be acute, and progress in all departments was retarded for this reason. The revenue and expenditure during the year 1922-23 were Rs. 12,57,75,165 (exclusive of the contribution of Rs. 3,48,00,000) and Rs. 12,60,76,848 respectively.[1]

After two years of deficit budgets the year 1923-24 showed a surplus of 36 lakhs of rupees. This surplus was utilised for the purpose of paying off a portion of the accumulated deficits of previous years. The realisation of this surplus was due both to restriction of expenditure within proper limits and to the increase of 41 lakhs on the revenue side of the accounts, largely, under the heads 'excise' and 'stamps.' The curtailment of expenditure, in spite of adverse circumstances, was the result, in the main, of the policy of retrenchment that was pursued throughout the year. The revenue of the year 1923-24, exclusive of the provincial contribution, was Rs. 12,99,38,109, while the expenditure amounted to Rs. 12,63,07,338.

[1] The provincial share of income-tax receipts amounted to Rs. 1,39,023 only against Rs. 39,88,842 in 1921-22, the decrease being due to an alteration in Devolution Rule 15.

The year 1924-25 was an abnormal one for Madras, due to the combined effects of famine and floods of an unprecedented magnitude. The year thus closed with a deficit of 23 lakhs. This was mainly the result of decrease in revenue under the heads 'land revenue' and 'excise.' This decrease in revenue was, however, to some extent counterbalanced by a diminution in expenditure under various heads. The income and expenditure of the year were Rs. 12,79,03,158 and Rs. 13,08,50,473 respectively.

In the budget estimates for 1925-26 a considerable deficit was apprehended. Subsequently, however, the provincial contribution for the year was remitted by the Government of India to the extent of Rs. 26·02 lakhs. This factor, combined with some minor modifications made after the budget had been presented to the Legislative Council, was expected to convert the deficit into a surplus. It was, therefore, proposed to utilise this anticipated surplus mainly on schemes of new expenditure in the transferred departments. The expectation was not, however, realised, because of the charges incurred in connexion with the damage caused by the floods and cyclones. The accounts of the year were as follows: Income, Rs. 14,71,35,400 (excluding a provincial contribution of Rs. 2,21,98,000); Expenditure, Rs. 13,72,98,669. Thus the year closed with a surplus of Rs. 98·36 lakhs.

The budget estimates for 1926-27, as presented to the Legislative Council on the 2nd March, 1926, anticipated a deficit of Rs. 76·46 lakhs, liberal provision having been made for new schemes of expenditure. The remission of a further sum of Rs. 57 lakhs in the provincial contribution, combined with an improvement in the revenues converted the deficit into a surplus of over a crore of rupees, in spite of the fact that certain further demands were voted by the Legislative Council when supplementary estimates were presented. The revenue and expenditure of the year 1926-27 were Rs. 15,18,49,735 and Rs. 14,17,01,929 respectively.

The year 1927-28 opened with a balance of about 2 crores of rupees. The total revenue amounted to Rs. 17·56 crores, while the expenditure was Rs. 15·55 crores. The opening balance on the 1st April, 1928 was 4 crores; the revised estimates of the year 1928-29 showed a revenue of 18·07 crores and an expenditure of Rs. 16·84 crores. A great expansion of Government programmes took place in these years in various fields of activity. For the year 1929-30, a revenue of Rs. 18·07 crores and an expenditure of Rs. 17·26 crores has been estimated. A large number of new schemes has been provided for in this budget. The ultimate cost of the schemes incorporated into the budget is Rs. 46·66 lakhs recurring and Rs. 165·55 lakhs non-recurring: but the amount

required in the current year is 31·11 lakhs recurring and 86·02 lakhs non-recurring. The claims of all the departments, including the nation-building departments have received consideration; while the cultivation of the æsthetic sense has found recognition in the establishment of a School of Fine Arts.

The first budget of the Government of Bombay under the reformed system of administration was a deficiency budget. The revenue was estimated at Rs. 13·48 crores for the year 1921-22 and the expenditure at Rs. 15·61 crores. A deficit of 2·13 crores was thus apprehended on the year's working. The position disclosed by these figures was due in part to a diminution in revenue, but mainly to additional expenditure. As the Finance Member pointed out at the time of presenting the budget, the primary reason for the excess of expenditure was the fall in the value of the rupee. The cost of materials purchased for the Public Works Department considerably increased and Government servants of all grades had to be granted additional remuneration. The total of this additional expenditure amounted to something over 3 crores. It was considered unfair to ask the new Legislative Council at its first sitting to raise fresh taxation and it was decided to meet the deficit by drawing upon the opening balance which amounted at the time to 3 crores.[1]

[1] "During the war," said the Finance Member, "when the most

The budget presented for the year 1922-23 disclosed the financial position thus: opening balance, 87 lakhs; receipts, 1,427 lakhs; expenditure, 1,545 lakhs; deficit, 118 lakhs; closing balance, *minus* 31 lakhs. The necessity for obtaining equilibrium between revenue and expenditure rendered fresh taxation imperative. It was proposed to turn this *minus* balance into a *plus* balance of 69 lakhs by the levy of taxation to the extent of a crore. The Legislative Council, however, was not satisfied that the Government had reached the limit of effective retrenchment, and threw out the first Taxation Bill, at the same time intimating that further taxation would not be agreed to without further retrenchment. The situation created by the action of the Council was carefully considered by the Government. It then gave the Council an assurance that a further cut of 60 lakhs would be made in the estimates. This assurance was accepted by the Council, and the other Taxation Bills were passed.[1]

The chief features of the financial administration during the year 1922-23 were the passing

rigid economy was enforced, we kept expenditure below income and saved on an average 70 lakhs a year. Here, then, is the situation in a nutshell. Our balances are gone. Against the annual surplus of 70 lakhs we have incurred recurring liabilities of over 3 crores for salaries. We have lost the expanding revenue of the income-tax. Our excise revenue is threatened with extinction, while in the shape of provincial taxation no increase whatever has been made." *Vide Financial Statement, 1922-23.*

[1] *Administration Report of the Bombay Presidency, 1921-22.*

of the Indian Stamp (Bombay Amendment) Act and the Court-Fees (Bombay Amendment) Act by the legislature. These Acts came into effect from the 1st April, 1922. It was estimated at the time that, by the operation of the new Acts, stamp revenue would be increased by Rs. 80 lakhs. There followed, however, a general depression in trade. This affected the stamp revenue severely, and in spite of the revision in taxation relating to stamps there was a fall of about Rs. 53 lakhs in revenue derived from this source.

To meet the wishes of the Legislative Council in effecting retrenchment, the Government not only cut down the budget estimates by Rs. 60 lakhs, but reduced expenditure by a further sum of Rs. 38 lakhs. The total retrenchment thus amounted to about a crore of rupees. There was a revenue of 14·17 crores and an expenditure of 13·53 crores, resulting in a surplus of 64 lakhs in the year 1922-23.

In presenting the Financial Statement for 1923-24, Mr. H. S. Lawrence, the Finance Member, summed up the financial situation in the Bombay Presidency by observing that the expenditure of the Government had been brought within the limits of its current resources and that it would be possible to carry on for the ensuing year without asking the Council for fresh taxation. After two years' disturbance, political as well as economic,

the Presidency was now in a far stronger position than when the first budget under the Reforms had been presented. The Finance Member took this opportunity to discuss the position created by the Meston Settlement. He observed that Bombay and Bengal collected respectively income-tax exceeding 8 and 7 crores, but practically the whole of this was appropriated by the Central Government.

Mr. Lawrence added: " If we take into account both the income-tax and other revenues, then the total provincial contributions work out as follows : Bombay, 9 crores; Bengal, 7½ crores; Madras, 6 crores; United Provinces, 4 crores; Punjab, 2½ crores; or if we take the percentages of the total revenues collected within these provinces, as shown in the budgets of 1922-23, then the percentage payments of the provinces are as follows: Bombay, 39; Bengal, 41; Madras, 31; United Provinces, 26; Punjab, 24."

In opening the budget session of the Legislative Council in February, 1924, the Governor of Bombay, Sir Leslie Wilson, pointed out that it was a source of satisfaction that the Government could present a budget which, in spite of increased expenditure, showed a surplus of revenue over expenditure, while maintaining such a balance as was necessary to keep in hand, having regard to the precarious character of the annual revenue of the province. This result had not been obtained

without the most stringent economy, and he regretted that fuller provision had not been made for public services such as education, medical relief, roads and other public needs. He then criticised the Meston Settlement and put forward an earnest plea for its revision. The Finance Member stated that the province of Bombay was contributing some 8 crores of income-tax to the Government of India, or 40 per cent. of the total income-tax of all India, and received nothing during the year 1923-24 out of all this vast revenue. This was due to the fact that the assessed income for that year had been below that of the datum line of 1920-21—a year of unexampled industrial prosperity.[1]

In the course of the year 1924-25, an unfortunate set-back occurred under the most important head of land revenue. The final accounts of the year showed a total decrease of $45\frac{1}{2}$ lakhs.[2] It thus became necessary to augment the income. But the proposal of the Government for the continuance of the enhanced rates of court-fees,

[1] He, however, mentioned with satisfaction the fact that at a meeting of the Finance Members of all the provinces convened by the Government of India at Delhi in the middle of November of the previous year, it had been unanimously agreed that it was necessary to set on foot a scientific examination of all the sources of public revenue throughout India.—*Administration Report of the Bombay Presidency, 1923-24.*

[2] The revenue under this head was subject to heavy fluctuations owing to the policy of grant of suspensions and remissions on a liberal scale.

levied originally for a period of two years under the Court-Fees (Bombay Amendment) Act I of 1922, was negatived by the Legislative Council. The revenue of the year 1924-25 amounted to Rs. 14·99 crores and the expenditure to Rs. 14·72 crores. The proceeds of a loan floated during the year amounted to Rs. 8·95 crores, and the loan expenditure was Rs. 8·52 crores.

The opening balance for 1924-25 was Rs. 5·45 crores and the closing balance Rs. 4·67 crores. The reduction was due to the fact that 79 lakhs of rupees were applied to the avoidance of debt. The Government had proposed to borrow this sum for irrigation, but owing to the increase in the opening balance they had met the expenditure on irrigation from balances instead of from loan money and saved thereby 4½ lakhs in interest.

On the occasion of presenting the budget for 1925-26, Mr. Lawrence pointed out that land revenue had ceased to expand for the time being. The Government had postponed the execution of revision settlements and suffered loss estimated for the year at 4½ lakhs of rupees. The extension of the period of settlements in Sind to 20 years had also checked the increase of revenue. The demands for advance in every direction were very insistent, and the Government had had to reject and postpone many schemes which were admitted to be of great public importance. The

Finance Member said that, if extra taxation was not passed by the council, it would be necessary to cut down some of the services then being rendered to the public. He added that, as the frame-work of Government must be maintained if the administration were not to be allowed to lapse into chaos, it followed of necessity that such retrenchment must be made primarily in those departments which ministered to the more advanced needs of the community.[1]

The Finance Member pointed out that the Government of Bombay received no benefit from the income-tax collected in the Presidency and they had lost no opportunity of expressing their protest against the system which was established under what was known as the Meston Settlement.

During the year 1925-26, there was again a set-back under the head 'land revenue.' There was also a drop in the next important

[1] "The House," said the Finance Member, "is confronted with a very urgent issue, and it is necessary that that issue should be placed before it in the most plain and distinct terms. It is not possible for the Government to consent to a closure of courts of justice, to the dismissal of the public forces necessary for the protection of the people or to withdraw any of the officers required for the collection of revenue. The primary services of a civilised Government must be maintained in efficient working. I assume that there can be no dispute on this point. For we all know by observation, if not by personal experience, that nothing but the strong arm of Government can protect its citizens from the desperate adventures of wild and lawless men. It follows, therefore, that retrenchment must fall with a heavy hand on those services which are not essential to life, however beneficial they may be to the advance of prosperity and the higher ideals of civilisation."

source of revenue, namely 'excise.' Under 'stamps,' the actual realisation fell short of the estimate of 184½ lakhs by about 9 lakhs owing to continued depression in trade. From 'forests' the receipts were slightly in excess of the estimates. The operation of the entertainments tax was estimated to bring in a revenue of 9½ lakhs but a new measure providing for a tax on the totalizator having been sanctioned in the course of the year, the total revenue under this head amounted to 15¼ lakhs. The entertainments duty levied for admission to a race course was reduced from 50 per cent. to 25 per cent.; and this was responsible for a decrease of revenue under entertainments duty (excluding the totalizator tax) from 9½ lakhs to 7¼ lakhs.

When the budget estimates for 1925-26 were prepared, the Government was faced with a revenue deficit of 41 lakhs. It, therefore, placed before the Legislative Council the following taxation proposals: (*i*) increase in court-fees, estimated to yield Rs. 18 lakhs; (*ii*) the levy of a tax on the transfer of property in the city of Bombay, which was expected to bring in 18 lakhs; (*iii*) a totalizator betting tax expected to produce 6 lakhs.

The taxation proposals were thus designed to leave a small surplus of 1 lakh. The Council, however, refused (in the budget session) to accord its sanction to the Transfer of Property Bill, and the Court-Fees Bill was not proceeded with by

the Government after its first reading. But the Council, in its July session, passed a Bill empowering the Government to levy a tax up to 4 per cent. of the money put in the tote. The Government, accordingly, levied from December, 1925, a tax of $2\frac{1}{2}$ per cent., and this brought in an additional revenue of 8 lakhs. In regard to expenditure it should be noted that, after the retrenchment effort of 1922, the effects of which lasted over three years, the inevitable expansion had begun again. There were slight increases in many of the departments of administration. The contribution to the Central Government was reduced by Rs. 22 lakhs. The accounts of the year stood thus: revenue, Rs. 15·24 crores; expenditure, Rs. 16·15 crores ; deficit, Rs. 91 lakhs.

A deficit was apprehended for the year 1926-27, some of the important heads of revenue having failed to come up to the mark. It thus became necessary to make an earnest effort to augment the resources. The Legislative Council had sanctioned for one year only the increases in stamp duties under the Indian Stamp (Bombay Amendment) Act of 1922, and the Bill to enhance court-fees which had been rejected by the Council in the previous year, was expected to bring in an additional revenue of 10 lakhs. The anticipated revenue was not realised, and the total revenue under stamps was Rs. 1·67 crores as compared with Rs. 1·75 crores in the previous year.

The Legislative Council also passed in March, 1926, as a permanent measure, the Bill introduced by Government for levying an additional duty of 2 per cent. on all transfers of immovable property within the town and island of Bombay. This tax was expected to bring in about Rs. 11 lakhs per annum. The expectation was not, however, fully realised. On the expenditure side, the Report of the Advisory Committee on the Back Bay Reclamation Scheme showed that there would be a loss of 3 crores; and the Government decided to provide annually from the general revenues a sum of Rs. 20 lakhs, representing interest and sinking fund on a 60 years' basis.

In the course of his speech introducing the budget for 1927-28 the Finance Member, Sir Chunilal Mehta, pointed out that the situation disclosed by the budgets of the past two years could not be said to be satisfactory. The Legislative Council, the Government, and indeed, the whole Presidency had been at one in denouncing the Meston Settlement as being the root of all the financial difficulties. There was an impression abroad that greater economy could be achieved in the matter of public expenditure, but this view was contrary to facts and the experience of democracy. The activities of the Government were expanding in directions which were not only not contemplated before but where interference of the Government

was resented as objectionable. That the process of retrenchment could be carried on indefinitely and that it was possible to put a limit on public expenditure would, he thought, be belied by the experience of every member who had taken part in municipal or local board administration. Sir Chunilal pointed out that not only was the Finance Department continuously cutting down expenditure but had appointed a special officer to examine every Department and suggest in what directions further economies were possible. The Finance Member also dealt with the allegation that the reserved departments were allowed to obtain the major part of the revenues as their share, while the transferred departments were allowed to languish and starve. If the figures for 1921-22 were compared with those for 1927-28, he said, it would be seen that while the expenditure on transferred departments had increased by over 44 lakhs, the expenditure on the reserved departments had actually gone down by 15 lakhs. The expenditure on education had increased from 1·72 crores to 2·07 crores, while 'police' showed a decrease of nearly 21 lakhs.

Sir Chunilal Mehta also gave some interesting figures comparing the relative amounts of taxation in the various provinces and the manner in which the provinces spent their money. He said that, while it was true that the *per capita* revenue was higher in Bombay than in the other provinces,

it did not follow that the administration of Bombay was extravagant. The principal cause of the high *per capita* taxation was the large area administered with a comparative sparseness of the population, which made inevitable the employment of a larger number of officers per unit of the population than would otherwise be the case. Another important factor was the high incidence of salaries on account of the higher cost of living, a price which Bombay must pay for being a more urbanised and industrialised province than any other in India. It was true that Bombay spent more on administration than other provinces, but he thought it was admitted that Bombay gave more and better services. Moreover, in other provinces the local bodies undertook many services and financed them from local revenues, whereas in Bombay those services were undertaken by the Government or mainly financed by them.[1]

The accounts of the year 1927-28 showed a revenue of Rs. 13·95 crores and an expenditure (charged to revenue) of Rs. 13·79 crores. In the revised estimates of 1928-29 a small surplus was

[1] Another interesting section of the Finance Member's speech was that which dealt with the amount of expenditure which was under the control of the Bombay Government. Altogether, out of an expenditure of 15·85 crores, there were items which either could not be avoided or which it was not desirable should be reduced, amounting to 7·54 crores. Adding to that 99 lakhs paid to the All-India Services, 7 crores were left as the amount over which the Government had control.

expected, the revenue and expenditure being estimated at Rs. 14·43 crores and 13·79 crores respectively. For the year 1929-30, a revenue of Rs. 14·41 crores and an expenditure of Rs. 14·40 crores have been estimated. If the expectations are realised, the two sides of the budget will just balance each other, but there will be very little in the way of a surplus.

When the budget for 1921-22 was framed, the United Provinces had an opening balance of Rs. 89 lakhs.[1] The revenue was estimated at 13·30 crores, but anticipations were disappointed in the case of excise, forests and land revenue, and the actual receipts amounted to only Rs. 12·38 crores. On the expenditure side, the charges against revenue (including the provincial contributions) were estimated in the budget at Rs. 13·66 crores. The actuals rose to Rs. 13·86 crores, the excess being accounted for by the discount and interest charges on the loans raised during the year. Thus there was a deficit of nearly 1·48 crores in the accounts of the province in the first year of the reformed system. The revenue of the year 1922-23 was estimated in the

[1] In 1919-20, the United Provinces had an opening balance of 2·52 crores, which was "the result of restriction of expenditure during the War." Expenditure rose in that year with the revision of the pay of the superior services. During the following year, the revision of pay of the clerical and menial establishments added very appreciably to the expenditure and reduced the closing balance for 1920-21 to 89 lakhs.—*Administration Report, 1921-22.*

budget at Rs. 13·33 crores, but the revised estimate fell to Rs. 12·56 crores. The final result was that at the end of 1922-23 the province had a deficit of nearly 65 lakhs.

One of the causes of the unsatisfactory financial position of the province was the miscalculation of the Committee on Financial Relations. They had estimated the normal revenue of this province at 12·32 crores and the normal expenditure at 8·35 crores. In their estimate of revenue the Committee were not far wrong. But their calculation of normal expenditure was very wide of the mark. Including the contribution of 2·40 crores, the Committee's "normal" expenditure was 10·75 crores, whereas the expenditure for 1921-22 was 13·86 crores, and the expenditure in the following year was about 13·29 crores. Thus in the first two years of the new system the actual expenditure exceeded the Committee's estimate by no less than 5·65 crores.

Expenditure in excess of revenue was met from the United Provinces Loan Account. This loan was raised in the open market in 1921, its immediate purpose being to finance the construction of the Sarda canals, which were estimated to cost eventually 10 crores. Apart, however, from the Sarda canals, funds were urgently required for general development.[1] The total

[1] This loan was an adaptation of a form of a loan common in

proceeds of the loan (face value) were just under 4·20 crores. The capital expenditure charged to the loan amounted in two years to 2·30 crores.

The year 1922-23 had very much the same financial features as the previous year, namely, a fall in income and a rise in expenditure. It closed with a total balance of Rs. 1·38 crores. Still, as was remarked by the Accountant-General, the accounts of the year showed that it was a year of adversity and that curtailment of expenditure was absolutely necessary, if no further improvement of revenue was possible.

The year 1923-24 opened with a determined attempt to remedy the serious position reached in the two preceding years, when part of the proceeds of the Provincial Development Loan had to be used to defray ordinary recurring expenditure. Stamp duties and court-fees were enhanced, and a tax was imposed on motor vehicles. On account of continued depression in trade, however, the stamp revenue of the year fell short of expectations by some 26 lakhs. Even so, the total revenue rose by 23 lakhs above the previous year's total, while the measures of retrenchment adopted by nearly all the departments produced a saving of 25 lakhs on the budget estimate for the year's working.

America and known as "limited option." It was income-tax-free, bore interest at 6 per cent., and was issued at 93. It proved a very popular investment.

At the end of the year, in spite of a revenue deficit of 1·63 crores and an increase in indebtedness to the Government of India, the prospects were considerably brighter than at the start. The motor tax, which in the course of its existence yielded some 2 lakhs of revenue, was taken off by the Legislative Council. The finances of the province had thus begun to make a quiet and steady progress. The Economy Committee, whose report was published in February, 1924, made very sweeping recommendations in regard to every department. This was immediately followed by orders of the Government giving immediate effect to such of the recommendations as were deemed practicable and likely to result in savings without loss of revenue or of essential efficiency. Not all the proposals of the Economy Committee, however, met with favour, even from the keenest protagonists of retrenchment.[1]

When the year 1924-25 opened, the financial prospects were quite favourable. The budget provided for receipts under revenue heads amounting to Rs. 12·54 crores. Including debt heads, the closing balance was estimated at Rs. 1·05 crores, of which Rs. 62 lakhs belonged to the Famine Insurance Fund and Rs. 43 lakhs were available for general purposes. But the

[1] It was decided that no district was to be abolished, and the number of *tahsils* which would undergo amalgamation was to be much less than the Committee proposed.

disastrous floods of September, 1924, upset all calculations. There were heavy losses under the heads 'land revenue' and 'irrigation,' and the cost of restoring damaged canal works, roads, bridges and buildings and of assisting District Boards to restore similar damage in their spheres of operation came up to a high figure. Besides, considerable sums were advanced as *taqavi* loans. The total burden imposed on the province was about Rs. 1·27 crores, of which about 75 lakhs fell in the year 1924-25. The revenue receipts of the year 1924-25 amounted to Rs. 12·39 crores, while the expenditure was Rs. 12·82 crores. Under debt heads the total receipts amounted to Rs. 1·88 crores and capital expenditure to Rs. 2·14 crores. At the close of the year, therefore, instead of a surplus of 8 lakhs there was actually a deficit of nearly Rs. 43 lakhs.

The effect of the floods was also reflected in the budget for 1925-26. The Government anticipated a considerable deficit. The Court Fees (Amendment) Act ceased to have effect from the 1st May, 1924, leading to a reduction of stamp revenue. The Legislative Council declined to sanction an extension of the Stamp Amendment Act, which raised the deficit to Rs. 50 lakhs. Fortunately, just when the financial year commenced, the Government of India announced that they would reduce the contribution of the province by 56 lakhs, *i.e.*, from Rs. 240 lakhs to Rs. 184

lakhs. This concession was expected not only to cover the deficit but leave a substantial surplus. The financial position of the province at the end of the year was quite satisfactory, but on account of the additional expenditure incurred to meet the supplementary demands, the year closed with a deficit of Rs. $30\frac{3}{4}$ lakhs. There was a balance of Rs. 52 lakhs only, while the progressive revenue deficit increased from Rs. 1·83 crores to Rs. 2·14 crores.

Further loans of nearly two crores were taken, of which one and a half crores were expended on productive as well as unproductive works. The amount spent on the former was divided between the Sarda canal and the town improvement trusts of Allahabad, Cawnpore, and Lucknow. The loan for unproductive purposes was spent chiefly on police buildings and roads. There was a closing balance of nearly Rs. 50 lakhs from loans taken from the Central Government. Certain changes in the system of accounts caused the balance of the United Provinces Development Loan to rise to Rs. 1·86 crores.

In 1926-27, a further remission of 35 lakhs in the provincial contribution improved the financial position of the United Provinces. But unexpected expenditure in the form of arrears of interest, due to a change in the dates of payment decided upon by the Central Government, and charges on account of military pensions and contributions

of which no notice had been given at the time of framing the budget, caused the anticipated expenditure for the year to exceed the estimates. As a matter of fact, a variety of circumstances contributed to financial instability in 1926-27. Receipts fell short by a substantial amount, while the expenditure was considerably in excess. The year closed with a small revenue surplus of Rs. 5 lakhs. In the budget estimates for 1927-28, an excess of charges over receipts was anticipated. The entire remission of the contribution by the Government of India, however, not only improved, but completely changed, the situation. In consequence of this remission, a new expenditure of Rs. 36 lakhs was sanctioned. The year 1927-28 actually closed with a revenue surplus of Rs. 1·12 crores.

The budget estimates for 1928-29, on the expenditure side, allowed for 22 lakhs of new charges, 80 per cent. of which was to go to the transferred subjects. It was during this year that the province was able to look upon the future not only with hope but with confidence. New land settlements that had already begun were expected to add considerably to the resources of the province. It was also hoped that the Sarda canal, expected to be complete in 1930, would yield progressive increments in revenue.

The revised estimates for the year 1928-29 showed a revenue of Rs. 12·05 crores and an

expenditure on the revenue account of Rs. 12·26 crores. For the year 1929-30, a revenue of Rs. 13·07 crores and an expenditure of Rs. 12·38 crores have been estimated.

Under the financial arrangements introduced in connexion with the Montagu-Chelmsford Reforms, a predominantly agricultural province like the Punjab was undoubtedly a gainer. In the first year of the new system, this province gained under land revenue Rs. 1·19 crores; stamps, Rs. 41 lakhs; excise, Rs. 58 lakhs; irrigation (major works), Rs. 2·43 crores; in all there was a gain of Rs. 4·61 crores. Against this must be set the loss of income-tax (Rs. 23 lakhs), and of the assignments from the Central Government (Rs. 50 lakhs). The real gain to the province was thus Rs. 3·88 crores. But as the province was called upon to pay a contribution to the Government of India of Rs. 1·75 crores, the net gain was reduced to Rs. 2·13 crores in the first few years of the reformed system. A large part of this sum, amounting to Rs. 1·54 crores, was, however, devoted to extra expenditure on irrigation, interest on loans, and other small items. For ordinary expenditure, therefore, an additional revenue of Rs. 59 lakhs was available in 1921-22. But, as a matter of fact, the year ended with a large deficit. The main reason for this was that a large additional expenditure was incurred owing to a substantial increase in the pay of establishments

necessitated by the rise in prices. Besides, on the income side, there was a fall in land revenue and excise due to bad harvests.[1]

This financial difficulty led the Government to consider the questions of retrenchment and imposition of additional taxation. It was, of course, undesirable to curtail productive expenditure on irrigation and forests which yielded large net profits to the Government. Retrenchment in expenditure being found difficult, the only alternative left to the Punjab Government was the imposition of additional taxation.

The revenue of the yearamounted to Rs. 8·77 crores, and the expenditure to Rs. 10·85 crores. There was thus a revenue deficit of Rs. 2·08 crores on the first year's working. The opening balance of the year was Rs. 1·40 crores. The whole of the balance was exhausted before the end of the year, and an advance of Rs. 65 lakhs had to be taken from the Government of India to meet the remainder of the revenue deficit. The Government felt justified in incurring large capital expenditure, for such expenditure, instead of being a drain on the resources of the province, was directly remunerative. It may be mentioned in this connexion that soon after the introduction of the Reforms, a new departure was made in the budget system in the Punjab, by which capital receipts and expenditure were entirely separated

[1] *Punjab Administration Report, 1921-22.*

from revenue receipts and expenditure.[1] The net capital deficit in 1921-22 amounted to Rs. 88 lakhs. Of the capital deficit, Rs. 35 lakhs were met by loans from the Government of India, and the remaining Rs. 53 lakhs by withholding the payment due to the Government of India on account of the balance of the Provincial Loan Account.

During the year 1922-23, the income amounted to Rs. 9·74 crores and the expenditure to Rs. 10·61 crores. There was thus a deficit of Rs. 87 lakhs on the revenue account. It was, therefore, decided to augment the resources of the Government by enhancing stamp duties and court-fees. A raising of the canal rates was also seriously considered. The Council, however, rejected a Government motion to appoint a Committee of Ways and Means to examine methods of raising new revenue. There was also a capital deficit which was met by a further loan of Rs. 41 lakhs from the Government of India. But it was felt that the Government of India would be unable permanently to finance the province by loans, and that it would be necessary for the province itself to raise money on its own credit. As a step towards this, the Punjab Government issued a

[1] *Punjab Administration Report, 1922-23.* A further change in budget form was made three years later, when a separate head of account for the record of extraordinary receipts was sanctioned by the Secretary of State.

loan at $6\frac{1}{2}$ per cent., of which Rs. 1·92 crores were taken up. This helped to cover not only the capital expenditure for the year, but also to repay the overdrafts from the Government of India on revenue account.

A revenue deficit of Rs. 63 lakhs was apprehended when the budget for 1923-24 was framed. The occupiers' rates on canal-irrigated lands were raised by executive order as the only available method of obtaining increased revenue. The actual working of the year, however, showed an income of Rs. 10·21 crores and an expenditure of Rs. 9·79 crores, leaving a revenue surplus of Rs. 42 lakhs. Thus financial stability was attained in the province in the third year of the reformed system of administration.

In presenting the budget for the year 1924-25, the Finance Member emphasised the importance of caution in embarking on new recurring expenditure. Land revenue and excise were subject to considerable fluctuations, and it was thought desirable to provide for lean years. This necessitated the search for new sources of income. A Stamp Act Amendment Bill and a Motor Vehicles Taxation Bill were passed.

The financial position was outlined by the Governor in his speech opening the 1923-24 session of the Council. He said: "Our capital position is good; we have already discharged half of the obligations incurred with our bankers

during our years of heavy deficit ; the rest we have placed on a sinking fund basis. We can count with confidence on larger capital receipts which will sensibly lessen the amount of loan money required to meet the commitments on our irrigation scheme. The revenue position, if not so bright, is nevertheless now on a sound basis. It will need careful nursing for some three years until our new ventures begin to recoup us for the expenditure incurred on them. At the end of that period, we may look with some confidence to a time when we can make a serious step forward in the expansion of those beneficent agencies which go to build up the character, the wealth, and the material comfort of the province."[1]

The income of the Punjab Government during the year 1924-25 showed a large increase, the total amount being Rs. 10·86 crores. Against this, there was an expenditure of Rs. 9·70 crores. There was thus a substantial surplus of Rs. 1·16 crores on the revenue account.

The financial improvement which began in 1923-24 went further in 1924-25 and became particularly marked in 1925-26. A net remission of Rs. 56 lakhs made by the Government of India in respect of the provincial contribution after the original budget had been voted, entirely altered the complexion of the provincial finances. In May,

[1] *Punjab Administration Report, 1924-25.*

1925, the Government announced the remission of water-rates on fodder-crops at an annual loss of Rs. $17\frac{1}{2}$ lakhs and a reduction in the scale of mutation fees at a loss of Rs. 3 lakhs. At the same time, demands were voted for large programmes of development in the various departments, and the estimates eventually provided for a small deficit on revenue account of Rs. 5 lakhs. It was, however, found impossible to work up to these large programmes during the year, and the actual expenditure on revenue account was Rs. 56 lakhs less than the budget estimates. The surplus thus created was swelled by unexpected increases of revenue. Land revenue and canal receipts were much larger than had been anticipated, owing to favourable seasons and to high prices of cotton. The yield from excise was greater than was expected, owing partly to increased consumption and higher auction fees. The revenue from stamps was also abnormally high; and though Rs. 40 lakhs of the extra revenue was credited to extraordinary receipts,[1] the actuals were still above the original estimates. The net result was that the ordinary income of the year 1925-26 was Rs. 11·39 crores,

[1] This was a new head first opened in 1925-26. The classes of receipts credited to this head varied from time to time, but it may be said generally that only those items were recorded as extraordinary which represented large non-recurring receipts of a capital nature. The most important of these were the proceeds of the sales of Government land.

and the expenditure, Rs. 10·26 crores. There was thus a large revenue surplus of Rs. 1·13 crores.[1]

During the year 1926-27, there was a further remission of the provincial contribution to the extent of Rs. 28 lakhs. This, however, was counterbalanced, in part, by a reduction in court-fees and a falling-off in irrigation receipts owing to a partial cotton failure. The general opinion in the Legislative Council was in favour of a large measure of relief from taxation than the 17 lakhs it was decided to remit, but the claims of development were also generally recognised. The receipts were Rs. 10·87 crores including 10 lakhs transferred from the Revenue Reserve Fund, while the expenditure, including a transfer of Rs. 20 lakhs to the Revenue Reserve Fund, was Rs. 10·85 lakhs. Revenue receipts, excluding extraordinary receipts, thus exceeded revenue expenditure by two lakhs. The increase in expenditure was mainly due to expansion in the education, medical, public health, agriculture, and co-operative departments, besides additional charges entailed by the recommendations of the Jail Enquiry Committee, an addition to the cadre of Extra Assistant Commissioners and an increased outlay on buildings, roads, and drainage works. The capital expenditure exceeded the capital receipts during the year by Rs. 2·09

[1] *Administration Report of the Punjab, 1925-26.*

crores which was met from extraordinary receipts. No loan was taken from the Government of India.

The final accounts of the year 1927-28 showed a revenue of Rs. 12·06 crores and an expenditure (charged to revenue) of Rs. 11·86 crores. In the revised estimates for 1928-29, the revenue was anticipated to be Rs. 11·51 crores and the expenditure Rs. 12·02 crores. The deficit was due to the fact that the expenditure included a large capital sum charged to revenue amounting to Rs. 72 lakhs. Besides, there was a blighted wheat harvest which was followed by a cotton crop much below the expectations of the Government. But as the Finance Member observed in the Legislative Council, the fianancial system of the Punjab was "no fair weather structure." The strain was withstood, and in face of all disappointments the policy of development was steadily pursued. The total revenue and expenditure (charged to revenue) for 1929-30 have been estimated at Rs. 12·54 crores and Rs. 11·49 crores respectively. The latter includes a capital expenditure charged to revenue amounting to Rs. 30⅔ lakhs.

The financial settlement with Bengal left the province with sources of income most of which were very inelastic. Consequently, the financial history of Bengal in the first three years of the new system was a record of the endeavour to balance the two sides of the budget by a rigid curtailment

of expenditure on the one hand, and by increased taxation on the other. When the Finance Member presented the first budget under the Reforms, he was faced with a deficit of Rs. 2·08 crores. Under the heads of revenue assigned to the province, the receipts were estimated at Rs. 10·81 crores, while the expenditure charged to revenue was expected to amount to Rs. 12·89 crores. One of the main causes of the increased expenditure was the enhanced pay which it was necessary to give to all the services, in view of the economic situation arising out of the War. Another cause was that during the War expenditure had been kept under check so that even measures of ordinary maintenance had been suspended or curtailed. The position was a difficult one; it was recognised that it would not be fair to prejudice the chances of success of the Reforms by asking the Legislative Council to face fresh taxation at the very start. The Finance Member, therefore, proposed to meet the deficit out of the provincial balances which then stood at Rs. 2·48 crores, in the hope that before the time came for the framing of another budget there would be an improvement in receipts and a diminution in liabilities.[1]

By the time the budget for 1922-23 came to be prepared it was clear, however, that these expectations were not likely to be realised. As a result of the protests of the Provincial Government the

[1] *Report on the Administration of Bengal, 1922-23.*

Government of India agreed to waive the contribution of Rs. 63 lakhs for a period of three years. But this relief fell far short of the requirements of the province. Attention was then directed to economy in administration, and the different departments were subjected to rigid scrutiny to find what retrenchments were possible. It was decided that the creation of the new district of Hijli on which considerable sums had already been spent, should remain in abeyance, that the activities of the public works department should be restricted only to works in progress, and that the settlement programme should be reduced. In these and other ways it was thought that a retrenchment to the extent of Rs. 89½ lakhs would eventually be secured. As against this, there were some unavoidable increases amounting in all to Rs. 17 lakhs.

But even at this reduced level of efficiency, there was a prospective deficit of Rs. 72½ lakhs. It was, therefore, no longer possible to avoid fresh taxation. Three Taxation Bills were introduced in February, 1922, two of them for amending the Stamp and Court-Fees Acts, and the third for imposing a tax on amusements. It was estimated that the new duties would bring in over a crore and a half of rupees. By the end of the financial year, these anticipations were found to be too optimistic. The revised estimates showed a large saving, owing to retrenchment,

but there was a substantial decrease in receipts. The actual accounts of the year 1921-22 turned out to be as follows: Receipts, Rs. 9·87 crores; Expenditure, Rs. 12·53 crores. There was thus a huge deficit of Rs. 2·66 crores. This was met out of the opening balance.

During the year 1922-23, the Finance Department was compelled to curtail expenditure to a still further extent, providing only for the barest needs of the administration. The collections from additional taxes in the course of the year was expected to restore equilibrium and leave a reasonable surplus, but once more anticipations failed to materialise. By September it was evident that the yield of the increased stamp duties and the amusement tax was likely to belie expectations. The Government was thus faced with another large deficit. It was necessary, therefore, to take immediate measures to enforce all possible economy and to suspend the expenditure sanctioned by the Council on schemes which had not been put in operation or to which the Government was not committed. A strong Committee was appointed with Sir R. N. Mookerjee, one of the most successful businessmen of India, as Chairman, to suggest measures of retrenchment.

These measures produced the desired effect, and the net result of the year's working was the comparatively small deficit of Rs. 26 lakhs, the

total revenue amounting to Rs. 9·85 crores and the expenditure to Rs. 10·11 crores.

At the time of framing the budget for 1923-24, it was estimated that the year's revenue would amount to Rs. 10·20 crores and the expenditure to Rs. 10·14 crores. Actual collections, however, fell slightly short of the estimate; and the retrenchment which was made in pursuance of the recommendations of the Bengal Retrenchment Committee, in addition to the economies effected in the previous year, led to a considerable reduction in expenditure. The actual accounts, therefore, stood thus: Revenue, Rs. 10·13 crores; Expenditure, Rs. 9·78 crores. There was thus a surplus of 35 lakhs of rupees.

During the following year, there was some increase in revenue owing mainly to an improvement in the receipts from non-judicial stamps. On the other hand, the expenditure was kept rigidly down, postponing even the most urgent measures of development in the nation-building departments. The result was that the actual income and expenditure amounted to Rs. 10·31 crores and Rs. 9·76 crores respectively, giving a surplus of 55 lakhs of rupees on the working of the year.

In presenting the estimates for 1925-26, the Finance Member again dwelt on the inadequacy of the revenue allotted to the province by the Meston Committee and the further inequity of the provincial contribution which had to be provided for in

the budget pending the decision of the Central Government. He pointed out how it had been impossible, ever since the fateful award, to embark on any new schemes, involving a permanent charge on the revenue. "We have not," he said, "abated our claim for an entire revision of the Meston Settlement, but we cannot go on marking time and allowing the proceeds of our new taxation to be swallowed up merely in maintaining the normal wants of the administration without making any progress or development." The estimates (omitting the provincial contribution which was remitted by the Government of India) anticipated receipts and expenditure of Rs. 10·55 crores and Rs. 10·77 crores respectively. On account of the apprehended deficit, the registration fees were considerably enhanced. The actual receipts and expenditure of the year amounted to Rs. 11·04 crores and Rs. 10·60 crores respectively, leaving a surplus of Rs. 44 lakhs. The heads of revenue which exceeded anticipations by a large margin were stamps, forests, and registration. Under the last head, the improvement was due to additional taxation, and amounted to 52 per cent. of the income derived from this source.

The budget for 1926-27 was the first in which the Finance Member was able to provide small sums, recurring and non-recurring, for an extension of existing activities and the development of a few inexpensive schemes. This was possible

because it was assumed that the provincial contributions would not be levied again. The resources of the province were, however, still extremely limited, and it was felt that no real progress was possible until a fresh settlement was vouchsafed to Bengal which would be more in accord with the needs of the province. The actual receipts and expenditure of the year amounted to Rs. 10·50 crores and Rs. 10·70 crores respectively, leaving a net deficit of about 20 lakhs of rupees. This was met out of the opening balance.

The year 1927-28 ended with a small deficit of Rs. 4 lakhs. In the course of his budget speech in 1928, the Finance Member referred to the Statutory Commission and said that the Government of Bengal would urge that the Financial Settlement was wrong *ab initio* and treated Bengal most unfairly, and that it must be completely revised if the new constitution was to have any chance of success in Bengal. For the year 1928-29, a deficit of about Rs. 25 lakhs was estimated; but a windfall of Rs. 52 lakhs which the Government received during the year as probate duty on a rich estate, together with reduced expenditure under certain heads, was expected to convert the deficit into a surplus of Rs. 41 lakhs. A revenue of Rs. 11·11 crores and an expenditure of Rs. 11·73 crores have been estimated in the budget for 1929-30.

During the year 1921-22, the Government of Burma had an exceptionally large balance at its

disposal on account of the profits which had accrued from rice control during the previous year. The total amount of these profits was nearly 9¼ crores of rupees, and as it was impossible to arrange for the economical expenditure of such a sum except over a long period of years, the Provincial Government decided to repay to the Government of India in one instalment the entire amount (Rs. 3·38 crores) of the outstanding balances of the provincial loan account and capital expenditure on major irrigation works. For this purpose, a temporary loan was taken from the rice control profits fund, which was to be repaid in equated instalments to that fund in 20 years out of the ordinary provincial resources and to bear the same rate of interest as would have been charged by the Government of India. The payment of interest to the Central Government was thus saved to the advantage of rice control profits, without detriment to their ultimate expenditure on the purposes to which it had been decided to devote them.[1] The total provincial receipts for 1921-22 were Rs. 10·12 crores, while provincial expenditure was recorded at Rs. 9·98 crores.

In 1921-22 and 1922-23, a contribution of Rs. 64 lakhs was required from the Government of Burma by the Central Government. The

[1] *Burma Administration Report, 1921-22.*

total provincial revenue for 1922-23 was Rs. 8·95 crores and the expenditure was Rs. 11·11 crores. The most important items in the increase of expenditure were the issue of loans of Rs. 50 lakhs and Rs. 10 lakhs respectively to the Rangoon Port Trust and the Rangoon Development Trust.

The total receipts in 1923-24 were Rs. 8·84 crores, while the provincial expenditure was Rs. 9·84 crores. There were considerable increases in expenditure under civil works, education, administration of justice, and jails, balanced to some extent by a large decrease under loans and advances. There was also a substantial increase of expenditure classed as miscellaneous, due to larger contributions to local funds. During the year a Retrenchment Committee, appointed as the result of a resolution passed in the Legislative Council, held prolonged sittings to investigate the possibility of cutting down expenditure in various directions and made a number of recommendations for the more economical and efficient working of the different departments.

The total provincial revenue in 1924-25 amounted to Rs. 10·23 crores, an increase of Rs. 1·38 crores. Provincial expenditure for the year rose by about Rs. 99 lakhs to Rs. 10·47 crores. The provincial railways were taken over by the Railway Board from the 1st April, 1924.

In 1925-26, the contribution required from the Government of Burma by the Central Government

was reduced by Rs. 19·65 lakhs. The year's provincial revenue amounted to Rs. 10·65 crores—an increase of Rs. 42 lakhs compared with the realisations of the previous year, while expenditure rose from Rs. 10·53 crores to Rs. 11·25 crores—an increase of Rs. 78 lakhs over the previous year's figure. In 1926-27, the contribution required to be paid by the Government of Burma was further reduced. The total provincial revenue for the year 1926-27 amounted to Rs. 10·56 crores, a decrease of Rs. 9 lakhs as compared with the realisation of the previous year, while the expenditure rose by Rs. 67 lakhs to Rs. 11·92 crores. The increased provincial expenditure was due, among other causes, to the higher cost of the police which absorbed a considerably larger sum than in the year 1925-26. This was necessitated by the reorganisation of the system on the recommendation of the Police Enquiry Committee, and an increase in the district executive force.

The final accounts of the year 1927-28 showed a revenue of Rs. 10·73 crores and an expenditure of Rs. 11·97 crores. In the revised estimates for 1928-29, a revenue of Rs. 10·72 crores and an expenditure of Rs. 11·78 crores were expected. The budget for the year 1929-30 shows a revenue estimate of Rs. 10·59 crores and an anticipated expenditure of Rs. 11·37 crores. The latter includes about Rs. 50 lakhs of new expenditure.

The finances of Behar and Orissa presented difficulties at the very outset which exceeded those with which the other provinces were faced, owing to three main distinguishing features. In the first place, the Government of Behar and Orissa is, relatively to its size and population, the poorest in India. Secondly, it is the youngest major province and is, therefore, faced with the necessity of abnormal initial expenditure. Thirdly, its revenues suffer from a peculiar lack of elasticity. The greater part of the province is permanently settled, which means that the land revenue is fixed. The mineral resources of Chota Nagpur are very large, but under the Meston Settlement the provincial finances derived very little benefit from them. Though the future possibilities of increased forest wealth are considerable, the yield during these years was not large. The expansion of revenues from irrigation is conditional on the ability of the Government to incur heavy capital expenditure, which the province was not able to afford.[1]

These obstacles to the expansion of provincial revenues gave rise to widespread uneasiness in the Council. At the beginning of the financial year 1921-22, the opening balance stood at a little over a crore of rupees. When the budget was introduced, it was estimated that the recurring revenue would

[1] *Behar and Orissa in 1921.*

amount to well over Rs. 4·71 crores, while the expenditure was estimated at about Rs. 4·67 crores. But by the end of the year the situation had materially altered. As a result of the non-cooperation movement there was a large fall in excise revenue and a considerable reduction in receipts for stamps. On the other hand, the expenditure was substantially in excess of the estimates. The Council, however, showed reluctance in the matter of levying additional taxation, and urged the appointment of a Retrenchment Committee. The deficit was met out of the opening balance; but it was felt that additional taxation could not long be avoided.

The recommendations of the Retrenchment Committee received the attention of the Government, but it was found that, as the scale of expenditure of the province was very low, economy could not be carried far without loss of efficiency. At the time when the budget for 1922-23 was introduced into the Council, the financial situation was a gloomy one. In spite of the strictest economy and control of expenditure, the budget for this year allowed for an excess of expenditure over revenue of Rs. 53 lakhs, and the closing balance at the end of the year was estimated at only Rs. 7 lakhs. This acute financial position once more led members of the Legislative Council to complain of the small measure of financial control vested in that body under the reformed constitution, and induced them to criticise the Ministers for not

securing a larger proportion of the provincial revenue for the transferred subjects. Many reductions were also made by the Council in the demands for grants. Resort was, therefore, had to increased taxation. The Legislative Council sanctioned an increase in the registration fees and in the court-fees payable for civil and criminal litigation. An appreciable increase of revenue was also secured as a result of the arrangements made with the Government of Bengal in regard to the collection of income-tax.[1]

There was another method by which it was hoped to be able to increase provincial revenue from the mineral resources of the province. A large portion of the iron ore was in estates which were the property of the Government, and throughout the year discussions took place between various companies and the provincial Government as to the form and manner in which the State should

[1] The profits made from the mineral resources of the province were largely earned by firms whose central offices were situated either in Calcutta or in Bombay. But under the Income-tax Act the tax was paid in the province which contained their "principal place of business." The interpretation placed on this provision of the Act till 1921 deprived the province of a very large share of the profit derived from this tax. It was, however, decided in that year that the Income-tax Commissioners of the various provinces should settle between themselves as to the province in which the income-tax of any particular firm should be paid, and if they failed to come to an agreement the case was to be referred to the Government of India. As a result of this order, income-tax was paid in 1922 in Behar and Orissa by a number of business firms which till then had paid the income-tax elsewhere. *Vide Behar and Orissa in 1922.*

take its share of the profit from minerals. The gloomy forebodings of March, 1922, however, did not come true. The obligations of the financial year 1921-22 were met with the help of only a trifling inroad on the provincial balance. In the course of the year 1922-23 the financial position of the Government showed signs of material improvement, owing partly to an increase in revenue and partly to diminution in expenditure.

At the end of the year it was found that the receipts were actually in considerable excess of the expenditure. After that date the provincial balance steadily increased, and the financial position no longer gave rise to acute anxiety. The accounts for 1923-24 showed that the closing balance of the year was about Rs. 1·76 crores. In the budget for 1924-25 the revenue was estimated at Rs. 5·34 crores and the expenditure at Rs. 4·91 crores. In these circumstances, the Government felt justified in carrying a step further the policy on which they had cautiously embarked in the preceding year, namely, that of sanctioning new schemes of activity in the various departments of administration, and thus undertaking fresh financial liabilities often of a recurring nature.

The financial position of the province improved still further in the course of the year, and showed a surplus of Rs. 23 lakhs even after a substantial sum had been devoted to new schemes of development. The year 1925-26 opened with a balance

of Rs. 1·86 crores, of which nearly Rs. 40 lakhs represented the Famine Insurance Fund. Revenue was estimated at Rs. 5·44 crores, while expenditure chargeable to revenue, without providing for new schemes, worked out to Rs. 5·20 crores. It was eventually decided to allot Rs. 47½ lakhs to new schemes, which was to be met out of the balances.

When the budget for the year 1926-27 was introduced, it was estimated that the opening balance would be about Rs. 2·04 crores. The revenue for the ensuing year was calculated at Rs. 5·69 crores and the expenditure at Rs. 5·49 crores. It was decided, however, to utilise a portion of the accumulated balance for the purpose of development schemes, and new expenditure was sanctioned to the extent of over Rs. 62 lakhs, in addition to Rs. 5 lakhs spent in the shape of new loans and advances. When the year closed, it was found that the actual position was more favourable than had been anticipated. The closing balance was now estimated at about Rs. 1·63 crores. The actual accounts of the year stood thus: Revenue, Rs. 5·74 crores; Expenditure, Rs. 6·05 crores; Deficit, Rs. 31 lakhs.

The year 1927-28 closed with a revenue of Rs. 6·14 crores and an expenditure of Rs. 6·13 crores. In the revised estimates of 1928-29 the revenue was expected to amount to Rs. 6·18 crores and the expenditure to Rs. 6·38 crores. For the year 1929-30, a revenue of Rs. 6·19 crores and

an expenditure of Rs. 6·68 crores have been estimated.

In the Central Provinces, the year 1921-22 started with an opening balance of Rs. 51 lakhs, and was expected to close with a balance of Rs. $3\frac{2}{3}$ lakhs, the estimated receipts and disbursements being Rs. 6·08 crores and Rs. 6·56 crores respectively. The actual figures were: Receipts, Rs. 6·38 crores (including the opening balance); Expenditure, Rs. 6·37 crores. The closing balance was thus reduced to a very small sum.

In introducing the budget for 1922-23 in the Legislative Council, the Finance Member pointed out that the normal financial position of the province showed a large deficit. The Meston Settlement promised a net gain of Rs. 28 lakhs to the finances of the province; but additional expenditure of Rs. 1·78 lakhs on account of the cost of the reformed system of government, and of Rs. 74·78 lakhs on account of revision of pay of establishment to meet the increased cost of living, left a deficit of about Rs. 48 lakhs. A further sum of Rs. $33\frac{1}{2}$ lakhs was required to give effect to the proposals of the Committee appointed to settle the financial relations between the Central Provinces and Berar. Even this was not all. The policy of gradually working towards prohibition was bound to lead to a gradual diminution of the excise revenue. It was, therefore, necessary, in order to meet a large and increasing

deficit, to retrench or raise additional taxation or adopt both the courses. Mr. Standen pointed out that the Government had already effected considerable economies and was exploring all avenues of retrenchment. But he warned the Council that the savings which were possible were small in comparison with the deficit, and that it would take time to realise them. As economy alone would not suffice to meet the difficulties, he suggested that fresh taxation should be imposed.

The year 1922-23 started with an opening balance of Rs. 88 lakhs, but the budget estimates showed a deficit, excluding debt heads and capital expenditure, of Rs. 36·77 lakhs. Improvements in revenue and reductions in expenditure, however, produced an unexpected excess of revenue over expenditure, and the year closed with a balance of Rs. 77·62 lakhs, of which Rs. 30·64 lakhs represented the balance in the Famine Insurance Fund.

The causes which contributed to the favourable result were collection of suspended arrears, increased sale of forest produce, and interest collected on *taqavi* loans. The introduction at the end of the year of the revised stamp and court-fee duties also contributed to the increase. The proposed expenditure was substantially decreased, partly by reductions moved in the Council and accepted by the Government, and partly by economies. For the year 1923-24 the

Finance Member estimated a deficit of Rs. 15·13 lakhs.

In 1923, the budget had a much smoother passage than its predecessor, and in view of the substantial reductions already made by the Government, the Council was not prepared to make many further cuts. The net result of the budget for 1923-24, as finally passed, was that, excluding debt heads, the revenue and expenditure were estimated at Rs. 5·35 crores and Rs. 5·49 crores respectively.

In the course of the year 1923-24 there was a substantial improvement in the financial position, and the turning-point in the series of deficits which had crippled so severely the activities of the Government during the three previous years seemed to have been reached. This result was achieved by a strict policy of economy and retrenchment, aided by favourable seasons. Expenditure was reduced below the normal standard estimated by the Retrenchment Committee, whilst the revenue considerably exceeded the estimate. The financial prospects were, in fact, brighter than the most sanguine anticipations.

An important event in the financial history of the province during the year was the establishment of a financial settlement between the Central Provinces and Berar. In accordance with a resolution passed by the Legislative Council on the 3rd March, 1921, a Committee was appointed

"to submit to the Government a scheme for a financial settlement between the Central Provinces and Berar, which, while safeguarding the requirements of a single government, would secure that a reasonable share of Berar revenues should be spent for the benefit of Berar."[1] The recommendations of the Committee were accepted by the Government with a few minor alterations and came into force since 1923-24.

The budget for 1924-25 met with a remarkable fate. The Legislative Council refused its assent, by a majority, to all the votable demands in both the transferred and reserved departments, with the exception of a sum of Rs. 2 which was voted for the salaries of the two Ministers. None of the demands were considered on their merits. The Governor certified and authorised expenditure for

[1] The committee recommended that, excluding certain heads of central expenditure such as the administration of revenue, criminal and civil law, the collection of taxes, the general executive business of the Government, and famime relief, etc., from which the whole province derived benefit, the expenditure should be divided between the Central Provinces and Berar in the same proportion in which they contributed to the revenues, *i.e.*, in the proportion of 3 to 2. This formula was, however, to be applied subject to certain reservations. The new divisible expenditure budgetted for in the years 1923-24 and 1924-25 was as follows:—

Budget figures for		Total new divisible expenditure in thousands of rupees.	Central Provinces.	Berar.
1923-24	...	617	180	437
1924-25	...	584	174	410

the reserved and transferred departments in accordance with the provisions of Section 72-D (2), proviso (*a*) and (*b*) of the Government of India Act. As a result the budget for 1924-25 as finally passed by the Provincial Government provided for a total revenue of Rs. 5·31 crores and an expenditure (chargeable to revenue) of Rs. 5·21 crores, and a closing balance of Rs. 1·81 crores, including Rs. 1·11 crores in the Famine Insurance Fund. The revised estimates for the year showed an improvement even on these very satisfactory figures.

At the close of the year 1923-24 the province could well congratulate itself on having reached this position of financial security without having to make any serious sacrifices. The improvement that had taken place within the three previous years had been remarkable. The province could now with confidence look forward to a period of all-round progress and development.

The year 1924-25 was another year of continued improvement in the finances of the province. The final accounts for 1924-25 disclosed a very favourable state of affairs. The budget for the year 1925-26, as finally passed by the Provincial Government, provided for a revenue of Rs. 5·56 crores and expenditure chargeable to revenue of Rs. 5·59 crores, a free closing balance of Rs. 70·50 lakhs and a balance in the Famine Insurance Fund of Rs. 1·54 crores.

As introduced in the Legislative Council, the budget for 1926-27 provided for a revenue (excluding debt heads) of Rs. 5·74 crores and for expenditure chargeable to revenue of Rs. 6·01 crores, of which Rs. 5·54 crores were required to meet commitments and Rs. 43·81 lakhs were allotted for new works and schemes.

The accounts of the year 1927-28 closed with a revenue of Rs. 5·39 crores and an expenditure of Rs. 5·37 crores. The revised estimates for 1928-29 showed a revenue amounting to Rs. 5·47 crores, and an expenditure amounting to Rs. 5·64 crores. In the budget for 1929-30, a revenue of Rs. 5·55 crores and an expenditure of Rs. 5·26 crores have been estimated.

The first year of the Reforms era was one of financial difficulty for Assam. The provincial revenue was Rs. 1·81 crores, while the expenditure was Rs. 2·05 crores. The deficit was met out of the balance which was reduced from Rs. 48 lakhs to Rs. 6½ lakhs. The expenditure, however, included an extraordinary amount of Rs. 16½ lakhs on account of the outstanding balance of the Provincial Loan Account paid to the Central Government during the year. In 1922-23, there was a slight increase of revenue due in part to normal expansion and partly to the enhanced duties introduced by the Court Fees (Amendment) and Stamp (Amendment) Acts of 1922. The expenditure of the year was considerably

less than that of the previous year, the main cause of the decline being the omission of the item relating to the payment to the Central Government on the Provincial Loan Account. The actual figures of provincial income and expenditure were Rs. 1·84 crores and Rs. 2·05 crores respectively. There was thus a small deficit which was met out of the balance.

In 1923-24, there was an appreciable increase in revenue, which was accompanied by a fall in expenditure. The actual accounts of this year stood thus: Income, Rs. 2·10 crores; Expenditure, Rs. 1·90 crores; Surplus, Rs. 20 lakhs. The province was thus able in the course of the year to turn from its position of financial distress to one of solvency.

The expansion in revenue continued during the following year, taxes on income, excise, forests, customs and land revenue being responsible for the improvement. The increases under these heads were due to increased prosperity of the tea industry, rapid growth in the jute trade, better settlement of excise shops, extension of the operations of the forest department, increased output of kerosene oil, larger consumption of motor spirit, and general extension of cultivation. On the other hand, there was considerable increase in expenditure due to increased activities in various departments, particularly under the heads education, forests and public

health. The accounts of the year were as follows: Revenue, Rs. 2·30 crores ; Expenditure, Rs. 2·00 crores ; Surplus, Rs. 30 lakhs.[1]

The years 1925-26 and 1926-27 were also years of prosperity. In the first-mentioned year the revenue and expenditure were Rs. 2·50 and Rs. 2·28 crores respectively. In 1926-27, the income amounted to a little over 2·43 crores and the expenditure to Rs. 2·43 crores, thus leaving a small surplus. In introducing the budget for 1927-28 the Finance Member observed that the financial position of the province was decidedly better than it had been in the early years of the reformed system, but it did not justify anything save an attitude of caution on his part. He thought that, so far as could be seen, the only revenue heads under which considerable expansion could be hoped for were land revenue and forests, while the excise revenue was likely to shrink rather than to expand, since receipts from opium would practically disappear if the policy of restrictions was successful. As a matter of fact, there was during this year a striking increase under land revenue, which was mainly due to resettlement operations in the Assam Valley and an extension of cultivation. There was also an increase in income-tax receipts due to a change in the income-tax law and to a rise in the assessable income. The total revenue

[1] *Report of the Administration of Assam, 1924-25.*

of the year was about Rs. 2·71 crores. There was thus an increase of Rs. 90 lakhs, or about 33 per cent., since 1921-22. The remission of the provincial contribution of 15 lakhs further strengthened the financial position of the province. On the expenditure side, substantial allotments were made, both recurring and non-recurring, in the transferred as well as the reserved departments of administration. The total expenditure incurred during the year was Rs. 2·58 crores, representing an increase of less than 20 per cent. over the ordinary expenditure of the year 1921-22.

The actual revenue and expenditure in 1927-28 amounted to Rs. 2·69 crores and Rs. 2·51 crores respectively. The revised estimates for 1928-29 were: Revenue, Rs. 2·81 crores; Expenditure, Rs. 2·81 crores. For the year 1929-30 the revenue has been estimated at Rs. 2·79 crores and the expenditure at Rs. 2·93 crores.

A review of the financial positions of the provinces during the last decade shows that the first three years of the reformed system were years of financial distress in almost all the provinces. This was due, in the main, to increased expenditure entailed by the necessity to raise the salaries of Government officers of all grades. In some cases, the difficulty was accentuated by extraordinary calamities like famine and floods. But the resources which had been placed at their disposal by the financial settlements of 1920 not only

enabled most of the provinces to tide over these adverse circumstances, but made it possible for them, before long, to take in hand developments in various directions. They were also able to remit the fresh taxes levied during the period 1922-24. The reduction and the ultimate abolition of the contributions to the central exchequer further strengthened their position in the second half of the decade. At the present moment the resources of these provinces, if judiciously applied, are sufficient not only for the essential needs of government but also for improving, to a substantial extent, the moral and material condition of the people. The situation in three provinces, however, has been and still is entirely different. The resources of Behar and Orissa are very inadequate, and a substantial addition to these is urgently called for. The *per capita* income of Bombay is larger than that of any other province, but her scale of expenditure is also large. Her difficulty has also, in part, been due to the fact that several schemes of development were undertaken which failed to prove successful. The revenues of Bengal are so small relatively to her population that no progress has been possible in the province during the last decade, and even after the levy of a large amount of additional taxation, it has been found difficult by her to meet even the ordinary needs of her administration.

CHAPTER X

THE PROBLEM AND ITS SOLUTION

It is now generally recognised that the financial adjustments which were made between the Central and Provincial Governments in India on the introduction of the Montagu-Chelmsford Reforms have proved unsatisfactory. The main defects of these arrangements may be traced to the following causes: First, the authors of the Joint Report on Constitutional Reforms as well as the Committee on Financial Relations proceeded upon the assumption that, in order to give a substantial measure of financial freedom to the provinces, it was necessary to demarcate completely the tax jurisdiction of the Central Government from that of the Provincial Governments; secondly, it was assumed that there existed a natural line of demarcation between central and provincial sources of revenue; thirdly, sufficient attention was not paid to the elasticities of the various heads of revenue; fourthly, it was not realised that the effect of the financial arrangements would be to place the burden of provincial taxation mainly upon the agricultural classes, while the industrial classes

would contribute almost wholly to the central exchequer; fifthly, no serious attempt was made to find out the correct basis on which the distribution of resources among the provinces should be made; sixthly, the criterion actually adopted for such distribution of resources was not an equitable one; seventhly, symmetry was sought to be secured at the expense of equality; eighthly, the expedient to which it was considered necessary to have resort, in order to make up the deficiency in the income of the Central Government, made the authorities blind to the real nature of the financial settlements; and ninthly, the attempt to mitigate in some measure the injustice done to the industrial provinces turned out to be as short-sighted as it was ill-conceived.

A few words on each of these matters will perhaps help to make the position clear. Whatever might be the theoretical merit of the principle of a clean cut, the assumption of its necessity in a scheme of federal finance was not founded on the experience of other countries. Possibly, there was a confusion in the minds of the authors of the scheme in regard to two distinct ideas, namely, separation of resources and separation of heads of revenue. While the former must always be an essential factor in any scheme of real provincial autonomy, the latter is not. Even in countries where the federal idea has been pushed to its farthest limits, it has not been found either

possible or desirable to effect a complete separation between the sources of revenue of individual states and those of the federation.

Having decided to adopt the principle of a clean cut, the authors of the Joint Report proceeded to divide the total resources of the State into two parts, one of which they called central, and the other, provincial. The division was an arbitrary one; but its real nature was soon forgotten. Perhaps the authors of the Joint Report were the victims of their own misconception. The tendency grew among the officers of the Central Government and of those provinces which were favoured by the new system to regard a distinction as natural which was really artificial. This confusion helped greatly to cloud the issues and to distort the vision of the Committee on Financial Relations. It ought to be mentioned here that the terms of reference to the Meston Committee were of an exceedingly limited character. Besides, as they had to finish their labours in the course of three months, they had no time to go into any of the fundamental questions involved in the consideration of the subject. The confused notion also created a wrong impression in the minds of those who were in a position to remedy the defects of the scheme before they had assumed serious proportions.

The failure to give adequate consideration to the elasticities of the various sources of revenue,

with reference not only to the rival claims of the Central and Provincial Governments but also in view of the different circumstances of the different provinces, led to very unsatisfactory results. While the more elastic resources were made over to the Central Government, there were great divergences in the expansiveness of the revenues of the different provinces. Nor did the possibilities of expansion of these resources in the future, as distinguished from the present, receive due attention. Further, the bearing of the division of resources on the incidence of taxation or the principles of morality was completely lost sight of.

The anomaly of central and provincial taxation falling on different classes of the population tended to create a separation between the interests of the two categories of Government in the country. It also hindered industrial progress. Industries were a provincial subject under the Devolution Rules; but it was not unnatural on the part of a Provincial Government to refrain from incurring expenditure on schemes the benefit of which was to accrue to the Central Government.

A uniform treatment was sought to be accorded to the provinces by allotting to all of them the same heads of revenue. But it was forgotten for the moment that the yield of each of these sources of revenue varied from province to province. Thus the attempt to secure artificial uniformity

diverted the attention of the authorities from the real problem, namely, the need for securing substantial equality. The result was that agricultural provinces were benefited at the expense of the industrial provinces.

In an adjustment of financial resources, the question of basis is very important. If the amount of revenue raised within each province had been taken as the criterion of distribution, no province would have had any reasonable ground of complaint. But, evidently, such a basis does not seem to have found favour with those who were entrusted with the work of allocation. It would perhaps have been difficult to calculate exactly the amounts of revenue which were properly creditable to the different provinces, but even approximate estimates would have offered a far better solution of the problem than the one which was actually adopted. Population would have furnished another—though not quite as equitable a test as revenue—but this was not considered at all.

While the authors of the Joint Report did not adopt any definite basis for the purpose of allocating the resources, they kept in view one criterion, namely, actual expenditure. This was not in itself a safe or just criterion, but even this criterion was considered in a shape which was open to serious objection. Normal scales of expenditure were calculated with reference to a particular year, instead of a number of years.

This year itself happened to be an abnormal year, in which expenditure had been rigidly kept down in most of the provinces owing to the financial difficulties of the Government of India. Nor did the authors of the Joint Report keep in view, in framing their financial proposals, future expenditure needed to give effect to the most essential requirements of the various provinces.

The expedient of levying provincial contributions tended for the moment to hide the real disparities between the different provinces introduced by the new financial system. These contributions also helped to make the situation more complex in another way. No definite principle having been enunciated as to why contributions were demanded, the provinces were led to believe that these were of the nature of forced benevolences. It was, therefore, no wonder that some of the provinces raised the cry that they were being robbed of substantial portions of their legitimate incomes. The outcry against the contributions would have been less loud if it had been made clear that direct contributions had been fixed at comparatively high figures for those provinces whose indirect contributions were small, and *vice versa*. But nothing of the kind was done, the question of indirect contributions having been brushed aside in a thoughtless manner.

The climax of short-sightedness was reached with the framing of Devolution Rule 15. The

intention of the Parliamentary Joint Committee was a beneficent one, but the Rule was given such a shape that it failed entirely in its object. Instead of adding to the resources of the provinces for whose benefit the Rule was made, it gave "bonuses to individual provinces on a haphazard basis, while leaving the Government of India to bear all losses."[1]

The immediate consequence of the new arrangements was that the prediction of surpluses accruing to the provinces proved false, and most of them were faced with deficits in the early years of the reformed system of government. But a more serious result was an unequal and inequitable distribution of resources among the provinces. Some provinces obtained large revenues, while the shares of others were wholly inadequate even for their elementary needs. In these latter, not only was no development possible but it was found necessary to resort to retrenchment as well as additional taxation in order to carry on the routine duties of administration. The disproportion in the revenues of the different provinces in the first year of the reformed system was, in spite of the contributions, so striking that it ought to have made the authorities realise that the financial arrangements had been extremely unfair. But neither the Governor-General in Council nor the Secretary of State had time to pause and think,

[1] *Report of the Taxation Enquiry Committee, Ch. XVI.*

while subsequent action taken by them only helped to make matters worse.

In 1921-22 and 1922-23, resort to extra taxation was found necessary in order to meet deficits in the budgets of the Government of India. This additional taxation took, in the main, the form of enhancement of customs duties and taxes on income. When the financial position of the Central Government improved, the additional taxes were not taken off, but the extra revenue was utilised for the purpose of reducing and ultimately extinguishing provincial contributions. One wonders whether the authorities in India and in England realised that these additional taxes fell most heavily upon some of the provinces, while the benefit of the reduction and ultimate extinction of contributions went mainly to the others. A double wrong was thus inflicted upon the less fortunate provinces, first by placing inadequate resources at their disposal and then by taxing them for the benefit of the other provinces. The system also produced another undesirable result. It fostered provincial jealousies, which stood in the way of a harmonious development of the entire population of India.

The unequal distribution of resources among the provinces, which was brought into existence at the commencement of the reforms, appeared in its true complexion after the abolition of the contributions. In the budget

estimates for 1929-30, the revenues of the different provinces are shown as follows: Madras, 18·07 crores; Bombay, 14·41 crores; United Provinces, 13·07 crores; Punjab, 12·54 crores; Bengal, 11·11 crores; Burma, 10·59 crores; Behar and Orissa, 6·19 crores; Central Provinces, 5·55 crores; Assam, 2·79 crores.[1] Thus it happens that the largest province of India in respect of population ranks a bad fifth in the order of allocation of resources. Comment is hardly needed to show how unjust and arbitrary is the present system of provincial finance in India.

Though the provincial contributions succeeded in some measure in hiding the real nature of the financial settlement from the view of the lay public, its unsatisfactory character was patent from the very beginning to all who cared to look into the matter with any degree of attention. A few years' experience of the system must also have

[1] The disproportions appear even more striking when we consider the revenue per head of the population in each province. Taking the budget figures for 1929-30 we arrive at the following result: Burma, Rs. 8·02; Bombay, Rs. 7·44; Punjab, Rs. 6·06; Madras, Rs. 4·26; Central Provinces, Rs. 3·98; Assam, Rs. 3·66; United Provinces, Rs. 2·87; Bengal, Rs. 2·38; Behar and Orissa, Rs. 1·82.

If we compare the increases which have taken place in the revenues of the different provinces since 1912-13 and 1913-14, we find that the percentages of increase have been as follows: Punjab, 160; Madras, 131; Behar and Orissa, 92; United Provinces, 89; Bombay, 81; Burma, 81; Central Provinces, 75; Bengal, 66; Assam, 64. The budget figures for 1929-30 have been taken here for the purpose of comparison with the average of the two years 1912-13 and 1913-14.

convinced the Government that it had proved an absolute failure. Therefore, the most natural course for the Government of India to adopt, as soon as its financial position had improved to some extent, would have been to appoint a representative committee to examine the whole question afresh. Such a course was, in fact, suggested in the Legislative Assembly. But Sir Basil Blackett took up the strange position that the matter could only be reconsidered after the contributions had disappeared. One wonders how an intelligent and capable financier like Sir Basil failed to foresee the immense difficulty that was sure to arise in the way of a resettlement after the abolition of the contributions. It is possible that he felt that the recommendation of the Parliamentary Joint Committee left him no option in the matter. But, surely, a recommendation which was wrong in principle, and had been found to be unfair and partial in the light of actual experience, should not have been regarded as sacrosanct. Sir Basil ought to have acted on the principle that nothing could be considered to have been finally settled which was not settled aright. No right-thinking person, therefore, can help regarding the abolition of the contributions, without a further examination of the whole question, as premature and inexpedient. This has rendered the work of readjustment far more complex than it would otherwise have been.

But the difficulty will have to be faced, and an earnest effort will have to be made to solve the problem in the most equitable manner possible.

Two questions are involved in the problem of readjustment of financial relations in the country, namely, first, a re-allocation of the financial resources of the country between the Central and Provincial Governments, and, secondly, a re-distribution of provincial funds among the different provinces. A proper solution of the first problem will require a careful consideration of the relative needs of the Government of India and of the Provincial Administrations. The Central Government is, under the Devolution Rules, charged with some very onerous duties, the most important of these being defence, management of coinage, currency and the public debt, and maintenance and development of the main arteries of communication.

Defence is, undoubtedly, the most important function of a government ; but it is not one of those departments which entail ever-increasing expenditure. On the other hand, a substantial curtailment is possible in the expenses of this department. The Indian Retrenchment Committee of 1922-23, which was presided over by a man of the ability and experience of Lord Inchcape, recommended the reduction of the military budget to a figure not exceeding Rs. 50 crores, provided there was a fall in prices.

Even this sum was regarded by the Committee as more than what "the tax-payer in India should be called upon to pay," and it was, in their opinion, desirable to keep "a strict eye on military expenditure with a view to its further reduction."

There has been an appreciable, though not a large, fall in retail prices since 1921, but military expenditure has not been reduced below Rs. 55 crores. The net military charges amount at present to nearly 65 per cent. of the net revenue of the Government of India. This is far too heavy a burden for the country to be able to bear. It should be borne in mind in this connexion that there is hardly any civilised country in the world which spends so large a proportion of its resources on defence as India does. In nearly every country there is at the present moment a movement towards the reduction of armaments, and the League of Nations is constantly striving after the goal of universal peace. If the number of British troops be reduced, a substantial saving will ensue. Another direction in which reduction in expense may be looked for is Indianisation of the army including the officers' ranks. Military expenditure is thus easily amenable to a policy of reduction, and it is incumbent on the authorities to make earnest efforts towards the attainment of this purpose. It will not do to rely entirely on the advice of the military

authorities on this question, but military expenditure must be considered as part of the general policy to be pursued in respect of the finances of the country. Unless a reasonable limit is set to the military expenses, progress in the country will become impossible.[1]

Of the duties performed by the Central Government other than that of defence, some are of the nature of commercial undertakings. No expenditure has to be incurred in these departments, and some of them bring substantial revenues into the coffers of the Government. The other civil departments are not such as require continually increasing expenditure for their administration. As a matter of fact, the tendency ought to be in the opposite direction. It is strange that, with the introduction of the Reforms, while the bulk of the responsibility for a large number of important subjects was definitely transferred to the Provincial Governments, no reduction was made in the civil establishment of the Government of India.

[1] Sir Basil Blackett was of opinion that there was no prospect of reduction for some time to come. But Sir George Schuster takes a more hopeful view of the situation. On the occasion of presenting the Financial Statement for 1929-30, he observed: "The normal cost of the standing military charges is thus being steadily cut down and it is, therefore, possible to hold out a very definite hope that when the four years' programme of re-equipment is completed, that is to say, after the year 1931-32, the total military budget will, apart from any circumstances which cannot at present be foreseen, be substantially reduced."

Although the opportunity was missed on that occasion, there appears to be no reason why substantial savings may not be made in future in many of the civil departments which are at present under the control of the Central Government.

On the other hand, most of the subjects made over to the provinces are in constant need of development, and as such require ever-increasing funds for their support. The expenditure incurred under the head 'education' is inadequate in every province, and extremely small in some provinces. Primary education is regarded as one of the elementary duties of every civilised government; but it is strange that no steps whatever were taken by the Government in this direction until the introduction of the reformed system of administration. During the decade about to close, earnest efforts have been made in most of the provinces by Ministers to extend primary education, but in many cases they have been greatly handicapped by want of funds. Next to education comes sanitation. In no province is the amount of money at present spent on sanitation anything approaching what may be called adequate. Some provinces are notoriously unhealthy, and large schemes of sanitary development are required to make them habitable. But lack of resources stands in the way of effecting any improvements in these areas. Agriculture is the mainstay of the people of India; but provincial

expenditure under this head is ridiculously small. Industries have become a provincial subject under the Reforms, but large initial expenditure is required to develop them. Much the greater part of the resources of every province is at present devoted to the maintenance of law and internal order, and this disproportion in expenditure is one of the main causes of the bitterness and discontent which prevail throughout the country.

It is thus clear that, if the Provincial Governments are to perform their duties properly, they must be placed in command of resources which will not only be substantial in the beginning but expansive in future. It will be essential to bear this in mind in framing the future scheme of re-adjustment. A glance at the accounts of the period commencing from 1921-22 shows that the finances of the provinces, taken as a whole, have improved to a larger extent than those of the Central Government. This, however, does not give a wholly correct idea of the situation. The expansion of provincial revenues has been due to circumstances which are not likely to prevail in future.

This will be clear if we examine, in some detail, the heads of revenue which are at present central and those which are provincial. Of the central sources of revenue, 'customs' is the most important. Since 1922-23, the year in which the present scale of customs duties was fixed, their yield has increased from $41\frac{1}{3}$ crores to 50

crores, or by about 20 per cent. in seven years. This tax is thus a very expansive source of revenue. It is also very elastic, as it responds quickly and largely to an increase in the rates. In the pre-war year 1913-14, the yield of this tax was only $11\frac{1}{4}$ crores of rupees, but the successive additions to the rates during and after the war have been followed by large increases in the yield. As a matter of fact, the revenue derived from this source has increased by over 440 per cent. in the course of the last sixteen years.

Taxes on income are also elastic and expansive sources of revenue. In 1913-14, the income-tax yielded less than 3 crores of rupees. The revenue derived from this source largely increased as the result of additions made to the rates and the levy of the super-tax. The maximum yield of the combined taxes on income was reached in 1921-22. After that year, there was a falling-off in the yield. This was due to the depression which followed the tremendous after-war boom in trade and industry, and also to conflicts between labour and capital. But industrial and commercial revival is bound to come sooner or later, and the yield of these taxes is sure substantially to increase. Already signs have become visible of a tendency towards improvement, and it is not unlikely that there will be an expansion of income-tax revenue in the course of the next few years.

The duty on salt is a moderately elastic resource. The revenue derived from this source is fairly steady; and it tends to expand gradually, though slowly, with the growth of population and with the improvement in the economic condition of the people. In 1923-24, an additional revenue of nearly 3 crores of rupees was obtained by doubling the rate of duty on the article. It should, however, be remarked that an increase in the rate of the salt tax is undesirable, as it involves a hardship on the poorer sections of the people and is sure to intensify discontent in the country.

The fourth elastic resource of the Central Government is the net income derived from railways. This revenue is in the nature of a commercial profit. An arrangement has now been made by which the railways contribute to the general exchequer 5½ to 6 crores annually. There is no reason to apprehend any diminution under this head. As a large amount of capital expenditure has now been sanctioned for the development of railways, it is reasonable to expect that this source of revenue will grow substantially in future.

Opium revenue is likely to diminish rather than expand in future. Although this revenue has been fairly steady since 1921-22 and has even shown slight increases in some years, it is likely to decrease in future, in view of the efforts of the League of Nations to cope with the opium evil in foreign

countries and of the policy of Provincial Governments to discourage the use of the drug among the people. Tributes from Indian States are likely to remain constant. Coinage and currency will continue to yield profits, but substantial increases cannot be expected from these departments of governmental activity. Posts and telegraphs at one time yielded considerable profits to the Government, but these departments are at present worked at a loss. With more economical management, however, they may be made once more to contribute a small net annual income to the State.

Coming to the provincial heads of revenue, we find that land revenue proper, that is to say, the portion of it which remains after excluding the yield due to irrigation, has not, except in the Punjab, expanded appreciably since the introduction of the Reforms. The land revenue demand is permanently fixed in Bengal, Behar and Orissa, and in some parts of Madras and the United Provinces. No expansion is possible in these areas unless new lands are brought under cultivation. The Permanent Settlement is an eyesore to most officers of the Government, and it is generally believed that it was this attitude which was largely responsible for the treatment meted out to Bengal and Behar under the financial arrangements of the Reforms scheme. On economic grounds, a perpetual settlement made direct with the payers of land revenue may be

said to possess advantages as well as disadvantages. While the contribution of the people to the public exchequer based on the land becomes fixed under such a system, an improvement in the material condition of the people may make possible as large a contribution in other forms of taxation as might otherwise have been derived from an enhanced land revenue. The Permanent Settlement which was made with the Zemindars in 1793 must, however, be pronounced a mistake. But it should be remembered that this measure was enacted because, owing to the unsettled state of the country in those days, the collection of land revenue had presented great difficulties. The people of Bengal did not ask for this boon; even the Zemindars were opposed to the measure. The question of abolishing the Permanent Settlement is at the present moment one of expediency. The additional amount which may be derived from such abolition should also be carefully estimated. If it be considered desirable to take the step, the high officers of the Government should make a frank statement to that effect. In any case, the people of Bengal and Behar should not be made to suffer for the consequences of a policy to which they were not a party.

In the temporarily settled tracts, land revenue can only be increased, apart from fresh lands being brought into cultivation, when the periods of settlement are over and reassessments

fall due. It is a notorious fact that land revenue demands have been excessive in some parts of the country in the past, and it will cause a great hardship on the people to increase these rates still further. Besides, legislation has been enacted or is being contemplated in some of the provinces to lengthen the period of settlement and to fix the pitch of assessment. Thus it is not likely that this source of revenue will show the same degree of expansiveness in future as it has shown in the past. The portion of land revenue due to irrigation, however, has increased considerably in the last few years, and is likely to increase further in future with the extension of canals. It should be borne in mind in this connexion that it is only in four provinces that land revenue due to irrigation is a substantial source of income.

The net profits derived from irrigation constitute an important resource in the Punjab, Madras and the United Provinces, and to a smaller extent in Bombay. With the completion of the canals which are now under construction, irrigation revenue is sure substantially to augment in these provinces in the course of the next few years. Various other schemes are also likely to be taken in hand in future. Irrigation may, therefore, be regarded as an expanding source of revenue.

Excise revenue has considerably expanded during the last eight years. But in view of the attitude of the enlightened public towards this

source of income, its yield is more likely to diminish than to increase in future.

Stamp revenue is the only source of income which has expanded in all the provinces since 1921-22. But its expansiveness is of a moderate character. A little more than one-third of stamp revenue is derived from non-judicial stamps, and the rest from judicial. The former is not only a legitimate resource, but expands with the development of commerce and industry. The latter is derived from litigation, which is often regarded as a tainted source, while its elasticity is considered as evidence of an undesirable state of things from the social standpoint. Allied to stamps is the income derived from registration. The yield of this resource is not large, and its expansiveness is limited.

Coming to the potential sources of revenue, we find that, of the taxes which are mentioned in Schedule I to the Scheduled Taxes Rules as being under the control of the Provincial Governments, the only really remunerative and expansive source is the inheritance tax. If no province has yet tapped this resource, the reason is to be found in the difficulties which exist in the way of its imposition. Advantage has not been taken of the provision relating to a duty on tobacco because of the likelihood of its falling heavily upon the poorer classes and of the difficulty in the matter of its collection. The other taxes mentioned in the Schedule, such as the amusements tax and the

betting tax, have been levied in some of the provinces; but their yield has been found to be small, and any substantial increase of provincial revenues can hardly be expected from them.

From this review it is clear that while the duties entrusted to the Provincial Governments are such as entail ever-increasing expenditure, the resources which have been placed at their command are inadequate for their present needs and likely to prove more and more insufficient in future. On the other hand, the revenues which are at present under the control of the Central Government are, comparatively speaking, of an expansive character, while their ordinary needs are more or less stationary and even capable of diminution. The problem now is how to allocate the resources between the Central and Provincial Governments so as to place both these administrative authorities in possession of adequate funds.

In this connexion it is not necessary for us to discuss whether the present tendency of constitutional development in India is in the direction of a federation[1] or what type of a

[1] The authors of the Report on Constitutional Reforms wrote: "Our task is not like that of the Fathers of the Union in the United States and Canada. We have to demolish the existing structure, at least in part, before we can build the new. Our business is one of devolution, of drawing lines of demarcation, of cutting long-standing ties. The Government of India must give and the provinces must receive; for only so can the growing organism of self-government draw

federation is best suited to the conditions of the country. It is enough for our purpose that the Provincial Governments have been invested with statutory functions and that the preamble of the Government of India Act, 1919, lays down that the provinces are to be given as much independence of the Government of India as is compatible with the due discharge by the latter of its own duties. The provision of independent and separate resources is a part and parcel of the reformed system of administration upon which there can be no going back. If the present system of allocation has to be revised—as it must be revised—the revision ought to be made in a manner just and equitable to both the Central Government and the Provincial Governments.

Let us now consider which of the heads of revenue are suitable as central resources and which as provincial. In this connexion it will be necessary to get rid of the idea that some sources of revenue are inherently central and others are inherently provincial.[1] The distinction is an arti-

air into its lungs and live. It requires no great effort of the imagination to draw a future map of India which shall present the external semblance of a great new confederation within the Empire. But we must sedulously beware the ready application of federal arguments or federal examples to a task which is the very reverse of that which confronted Alexander Hamilton and Sir John Macdonald."—*Ch. V.*

[1] This was admitted even by Lord (then Sir James) Meston. In the course of his evidence before the Parliamentary Joint Committee, he said: "It is very difficult to see why any particular source of revenue, or at least many particular sources of revenue are inherently

ficial one, and has no basis in the nature of the taxes themselves. Although the federal system has not yet been adopted in India, she may profitably learn many valuable lessons from the experience of countries which are more or less similarly situated. Until recently, the line of division adopted in most federal countries was between direct and indirect taxes, the former belonging to the States and the latter to the Federal Governments. This distinction has been found impossible to maintain, and in most cases direct taxes are now levied by the Federal Governments as well as by the States. Thus while it is generally considered desirable to separate as much as possible the sources of revenue of the Federal Government from those of State Governments, in practice, an absolute delimitation of the spheres of taxation is not to be found in any country. On the other hand, the most distinctive aspect of the modern movement

either Central or Provincial, and any allotment of revenues which may be made must to some extent be artificial of necessity. Take land revenue, for example. It is true that land revenue has by tradition and custom become a provincial asset, but the origin of the land revenue was the right of the State to levy either a rent or a tax—there is bitter controversy as to the proper term to be used—from the occupier of every piece of land within the Imperial dominions, so that it might be held that land revenue is a central asset. I mention this as a danger of laying down any dogmatic line of division, but we have tried to lay down a line of division which roughly corresponds with actual facts and is also in consonance with our past traditions."—Reply to Question 7002. Unfortunately, Lord Meston did not take steps to give effect to these views as Chairman of the Committee on Financial Relations.

in all federations is to consider the question of taxation as one whole. "More and more," says Professor Seligman, "the fiscal problem is being envisaged as a totality, and the relative claims of the community, state and central governments are being considered from the point of view of an equitable distribution of the entire burden resting upon the individual or class." [1]

The objections taken by the authors of the Report on Constitutional Reforms to the system of divided heads are only partially valid. The argument that a complete separation of sources of revenue may narrow the basis of either the central or the provincial fiscal system or of both is not altogether unwarranted, and the experience of the past few years lends considerable support to this view. On the whole, it is clear that the defects of the system of divided heads are not greater than its merits. In the future allocation of resources, therefore, it will be undesirable to make a fetish of this avoidance of divided heads.

Coming to individual heads of revenue, we find that import duties form a federal resource in all countries, the principal reason being the necessity of avoiding inter-provincial barriers and the difficulty of tracing incidence. In India also, these duties must remain central. Export

[1] Professor Seligman describes this movement as "the most recent phase of modern tax reform," although it has not hitherto received sufficient attention.—*Essays in Taxation, Ch. XXVII.*

duties, however, stand on a somewhat different footing. In this case, the question of inter-provincial barriers does not arise, and it is not impossible to trace the origin of exported goods. Of the articles on which export duties are now levied, two claim our attention in this connexion, namely, jute and rice. Almost the entire proceeds of the duty on jute are obtained from Bengal, and this province has always demanded that a substantial share—if not the whole—of the proceeds of the tax derived from the ports of Calcutta and Chittagong should be made over to it.

Two objections are generally urged against such a proposal. The first is that the burden of the duty does not fall on the people of the province. But, as the Taxation Enquiry Committee point out, "there exists a possibility that, in certain conditions of the trade, a portion of the export duty may fall on the producer."[1] Even if it be granted, for the sake of argument, that the whole of the duty falls on the foreign consumer, the claim of the people of the province on a piece of good fortune which has fallen to its lot cannot be light-heartedly brushed aside. The second objection is that export duties ought naturally to be under the control of the Central Government. This objection can be met by providing that such duties should continue to be administered by the Government of India, but that

[1] *Report of the Taxation Enquiry Committee, Ch. XVI.*

one-half of the proceeds may be made over to the province. If, however, any fastidious critic objects to a division of proceeds, an arrangement may be made so that the export duty may be reduced to half its present amount, and the Provincial Government may be allowed to levy an excise duty of such an amount as will yield about half the proceeds of the existing tax. An objection to such an arrangement is that it would be undesirable for both Imperial and Provincial Governments to be interested in a tax of the nature of an export duty, since such an interest would render it "doubly difficult for the trade concerned to secure amelioration when it is due." There is, it is true, some force in this argument, but the objection is not really of so vital a character as is sometimes imagined. On the other hand, the interest of two Governments in this article may be of considerable benefit to the industry. If the Central Government, for instance, should decide to levy an excessively high rate of duty on the article, as was done in the case of saltpetre in the sixties of the last century, the Provincial Government would raise its voice of protest in the interest of its own revenues, if for no other consideration.

It should be borne in mind in this connexion that jute, both as an agricultural product and as a manufactured article, is a provincial subject and that its development engages the attention of the Government of Bengal, not of the Government

of India. Besides, the production of jute affects the sanitation of the province, and the expenditure needed to overcome its evil effects has to be met out of provincial revenues. On these various grounds, the claim of the province to at least a share of the income derived from the article seems to be legitimate. The conditions of the export duty on rice are not exactly similar to those of the jute tax. But in this case also, the incidence can be traced with some measure of accuracy. A part of the income derived from the duty on rice was at one time a provincial source of revenue in Burma. No possible harm can ensue if, under the rearrangement, this province is again allowed a share of the tax. On the whole, it would seem to be best to provide that export duties should continue to be levied by the Government of India, but the proceeds should be divided between the Central and Provincial Governments. The least that could be done in this matter would be to accept the recommendation of the Taxation Enquiry Committee, namely, that export duties should be used as a "balancing factor."

Excise duties are in most countries of the world a central source of revenue. But, in India, while the excises for revenue are central, the restrictive excises are provincial. There does not seem to be any justification for this differentiation except this that Provincial Governments have been responsible for the management of this branch of the public

revenue for a long time past. The Taxation Enquiry Committee recommend the transfer to the Government of India of the excise duty on locally-made "foreign" liquors as well as the income derived from excise opium. The Government of India are opposed to this proposal, but their arguments do not seem to carry much conviction. The suggestion is really a sound one, and should be accepted. The proceeds of these taxes may be used as a possible balancing factor. It would be a great advantage, indeed, to provincial finance if the whole of excise income were transferred to the Central Government and replaced by another source of revenue of an equal yield. But it does not seem likely that the Government of India will entertain such a proposal.[1]

The salt tax is in part a customs duty and in part an excise. As uniformity is essential in the rates of duty, and as its incidence is not traceable, it must continue to be a central resource. The net income derived from railways and from coinage and currency naturally belongs to the Central Government. So do tributes from Indian States.

[1] Mr. G. Findlay Shirras shows that if excise had been assigned to the Central Government in exchange for income-tax in 1926-27, the gain or loss to the different provinces would have been as follows (in crores of rupees): Madras,—3·83; Bombay,—·88; Bengal, +3·45; United Provinces, —0·57; Punjab, —0·59; Burma, +0·60; Behar and Orissa,—1·43; Central Provinces,—0·98; Assam,—·56.—*Memorandum and Statistical Tables on the need for readjusting Central and Provincial Finance in India.*

If posts and telegraphs can once more be made revenue-earning departments, the income should belong to the Government of India.

Income-tax is at present almost entirely a central source of revenue. But in all federal countries it is, either wholly or in part, a source of State or provincial revenue.[1] And there is no reason why India should form an exception to the rule. The arguments which were advanced at the time of introduction of the Reforms against making it provincial represent only one side of the case. The difficulties pointed out by the authors of the Reforms Report and by the Committee on Financial Relations are not peculiar to India. They have been faced in other countries, and it is not clear why these difficulties should be regarded as insuperable in this country. Besides, income-tax is the only tax at present levied in India, which is based on the principle of ability to pay, and the provincial tax-system must be regarded as extremely unsound so long as it does not include in its sphere the application of this principle.

"Land revenue and income-tax," it has been rightly observed, "are the complement of each

[1] In the United States, Canada and Australia, taxes on income were, until recently, levied only by the States. But now such taxes are levied by the Federal Governments as well as the States. In Germany, the yield of most of the direct taxes, including the income-tax, is shared between the *Reich* and the *Lander*. In Switzerland also, the system of division of proceeds prevails.

other, the former being a levy on agricultural incomes, and the latter on industrial incomes." It stands to reason, therefore, that when the one is made provincial, the other also should be provincial, at least in part. This is all the more necessary in view of the differences in the economic conditions of the different provinces. Some provinces are predominantly agricultural, others are mainly industrial. It should also be borne in mind in this connexion that industrial development is a provincial subject under the reformed system of administration. The fostering of industries requires expenditure; but it would be too much to expect a Provincial Government to spend considerable sums of money if it knew that the return would go to the central exchequer. There is another fact which ought not to be overlooked. In industrial areas, certain special arrangements have to be made for the maintenance of law and order and for the improvement of sanitation, which require expenditure out of provincial funds; but the Provincial Governments ought not to be made to feel that such moneys are entirely thrown away so far as their resources are concerned.

In depriving the provinces[1] of their legitimate claim to at least a portion of the income-tax revenue, the Committee on Financial Relations must

[1] The total amounts collected from the different provinces in the shape of taxes on income during the first seven years of the reformed

have felt some qualms of conscience, for they expressed a doubt whether it would be possible permanently to exclude the provinces from some sort of taxation upon industrial and commercial earnings. The Joint Select Committee of Parliament, though unwilling to make a radical alteration in the proposals, felt the injustice of the system, and attempted to give some relief to the aggrieved provinces by formulating Devolution Rule 15.[1] This Rule, as has already been noticed, has proved a miserable failure. Bengal and Bombay, for whose benefit the Rule was framed, have obtained

system (1921-22 to 1927-28) for which complete figures are available, were as follows:

Bengal	...	...	...	Rs. 37 crores
Bombay	...	...	...	,, 34·41 ,,
Burma	...	...	...	,, 11·78 ,,
Madras	...	...	...	,, 9·64 ,,
United Provinces		...	...	,, 6 ,,
Punjab	...	...	...	,, 4·45 ,,
Central Provinces		...	...	,, 3·11 ,,
Behar and Orissa		...	...	,, 3 ,,
Assam	...	...	...	,, ·91 ,,

[1] The Total amounts received by the provinces under Devolution Rule 15 during the years 1921-22 to 1927-28 were:

Bengal	...	...	...	Rs. 0·95 lakhs.
Bombay	...	...	...	,, 17·32 ,,
Madras	...	...	...	,, 31·32 ,,
United Provinces		...	...	,, 3·56 ,,
Punjab	...	...	...	,, 23·80 ,,
Burma	...	...	...	,, 35·30 ,,
Behar and Orissa		...	...	,, 17·40 ,,
Central Provinces		...	...	,, 14·37 ,,
Assam	...	...	...	,, 26·70 ,,

only Rs. 95,000 and Rs. 17¾ lakhs respectively under this Rule since the commencement of the Reforms. But the total amounts collected from these provinces in the shape of taxes on income by the Central Government have exceeded Rs. 45 crores and Rs. 40 crores respectively. While the injustice done to these provinces has been so glaring, the Rule has served one useful purpose, namely, that it has cut the ground from under the feet of those who objected to the division of the tax on the ground of the necessity of maintaining a financial clean-cut.

It is thus not only fit and proper but absolutely essential that income-tax should form part of the provincial resources. But if the entire proceeds of the tax be made over to the provinces, the financial position of the Central Government will become weak. Therefore, income-tax will have to be divided between the Central and Provincial Governments. No hesitation need be felt in this regard, for, as Professor Seligman puts it, the time of segregation of sources of revenue "has gone by."[1] The collection and management of the taxes on income should, however, remain in the hands of the Central Government.

The question now is—How is the division to be made? As the Taxation Enquiry Committee point out, there are three principal methods of

[1] *Studies in Public Finance, Ch. VIII.*

dividing the tax, namely, first, the provinces may be empowered to levy and administer an income-tax separate from that levied by the Government of India; second, the income-tax may continue to be levied by the Government of India, which may at the same time levy *centimes additionnels* for the benefit of the provinces; and third, the income-tax may continue to be levied by the Government of India, but a definite proportion of the yield may be allocated to the provinces on certain well-defined principles. The first method, although it still obtains in some federal countries,[1] has been condemned by competent authorities. Besides, an additional provincial levy is sure to prove a heavy burden on the people and create a great deal of discontent. The second method is also open to this objection; in addition, there are practical difficulties in the way of its adoption.[2] But the third method provides the most appropriate solution.

[1] This system exists in the United States and Canada. It also prevailed in Australia till 1923. In that year, the Commonwealth Treasury concluded various agreements with the Treasuries of the States for the common assessment and collection of Federal and State income-taxes. In 1926-27, a new arrangement was made under which a distribution of the proceeds of direct taxation between the Commonwealth and the States was effected. The income-tax raised for Commonwealth expenditure represented in this year £1 1*s.* 1*d.* per head of the population, and the same tax collected for the States, 13*s.* 3*d.* per head.—*Memorandum on Public Finance (1922-26)* published by the League of Nations.

[2] Professor Seligman, however, does not seem to regard these difficulties as very great, for he suggests that the income-tax should be

The next problem is to find a satisfactory basis on which the allocation is to be made. The simplest way of dividing the tax would be to give the super-tax to the Central Government and the ordinary income-tax to the Provincial Governments. The objection urged in the Joint Report, namely, that in the case of ramifying enterprises with their business centre in some big city, the province in which the tax is paid is not necessarily the province in which the income is earned, applies with special force to the super-tax. Besides, it is the industrial concerns of an all-India character which are likely to receive help and encouragement from the Central Government. On the other hand, industries which receive assistance from the Provincial Governments are generally small in size, whose activities are, to a large extent, confined within the borders of the provinces concerned. But such a division may fail to yield sufficient revenue to the Central Government in times of industrial or trade depression. It would also be wrong to deprive the provinces of a share of what may be called the excess profits of the big concerns. Thus it seems desirable to allot some portion of the ordinary income-tax to the Central Government and, at the same time, to make over a portion of the proceeds of the super-tax to

levied by the federal government of the United States, the States being allowed to tack on "additions for their own purposes or for local needs."—*Essays in Taxation, Ch. XII.*

the provinces. The simplest and most equitable system of allocation would be to provide that (1) so far as the ordinary income-tax is concerned, the collections on incomes of persons resident abroad should belong to the Central Government, (2) the remainder of the proceeds of the income-tax should go to the provinces, (3) the whole of the super-tax revenue should be an all-India resource, and (4) the corporation profits tax should be divided between the Central and Provincial Governments. The bulk of the ordinary income-tax should, in any case, belong to the provinces.

The Taxation Enquiry Committee propose to base the distribution primarily on the principle of domicile. Their idea is to give to the provinces the proceeds of a basic rate on personal incomes graduated proportionally to the general rate, allowing the Government of India to retain the whole of the collections on incomes that do not appertain to residents in particular provinces, such as the tax on undistributed dividends of companies or on incomes of persons resident abroad or resident in places outside the boundaries of the provinces concerned, as well as almost the whole of the super-tax. Such allotment would be open to exception on three grounds, namely, first, that it would present practical difficulties in working; second, that it would ignore altogether the principle of origin and thus penalise some of the provinces;

and third, that it would make the provincial portion of the tax unduly small. In order to meet partially the first objection, the Taxation Enquiry Committee recommend the assignment to each province of a small share of the corporation profits tax. This suggestion is a very sound one, for it is fit and proper that the provinces should be allowed to have some interest in a tax the proceeds of which represent the highest industrial and commercial activity of the province. But the Committee themselves admit that their main scheme is not scientifically accurate. Even more serious than this, however, is the objection that it would fail to satisfy the needs of the provinces. If, on the other hand, the scheme suggested in the previous paragraph be accepted, the provinces will obtain a fair share of the yield of taxes on income. The division of the proceeds of the tax between the different provinces is not likely to present an insuperable difficulty.

The next important source of revenue which is at present provincial is stamps. There is no dispute about judicial stamps and stamps used for conveyances, etc. These are recognised by all as eminently suited to be a provincial source of revenue. But there is considerable difference of opinion as to whether commercial stamps should be central or provincial. As has already been noticed, the Financial Relations Committee did not see

eye to eye with the authors of the Joint Report on this question. The Taxation Enquiry Committee express the opinion that in India it is not only highly inconvenient to have varying rates of duty, but also, so long as uniform stamps are maintained for the whole country, it is not equitable to continue the system of division of sources as in the case of stamp duties. It can hardly be denied that there is considerable force in this argument. But the first objection has already been met by keeping legislation in respect of commercial stamps in the hands of the Central Legislature, and this procedure is sure to be continued in future. As for the second, it is true that postal stamps are used also for various commercial transactions, and there is some amount of practical difficulty in dividing the proceeds of such stamp duties between the Central and Provincial Governments. But this difficulty is not of a very serious character; and if the working arrangements which exist between the Government of India and the provinces are examined from time to time and revised whenever necessary, grievances may be removed or at least minimised. It is difficult to see why the Taxation Enquiry Committee should make this particular head of revenue a question of equity. The real problem is to make an equitable distribution of the total revenues of the country between the Central and the Provincial Governments, and for this purpose

to divide the sources of revenue in such a manner as to secure adequate funds for both. There can be no objection to retaining commercial stamps as a provincial source of revenue, if it is found that, without this resource, the funds of the provinces will not be adequate.

In view of the experience of the past few years that the resources of some of the provinces have not been equal even to their ordinary requirements, and having regard to the fact that Provincial Governments have been entrusted with the management of subjects which urgently call for development, the great need of the hour is to make a substantial addition to provincial funds. If it be now decided to make over a portion of the proceeds of the income-tax to the provinces and at the same time to transfer commercial stamps to the Government of India, the gain of the provinces will amount to very little.[1] A careful consideration of all the aspects of the question, therefore, leads to the conclusion that commercial stamps should continue to be provincial.

[1] Mr. G. Findlay Shirras calculates that, if one-half of the income-tax were assigned to provinces and non-judicial stamps wholly assigned to the Central Government, the gain or loss (on the basis of the figures for 1926-27) to the provinces would be as follows (in lakhs of rupees): Bombay, +71; Madras, −36; Bengal, +163; United Provinces, +2; Punjab, −8; Burma, +71; Bihar and Orissa, +5; Central Provinces, +1; Assam, +1. The Government of India would lose 270 lakhs of rupees if the proposal were given effect to.—*Vide Memorandum and Statistical Tables on the need for re-adjusting Central and Provincial Finance in India.*

The remaining sources of revenue at present under the control of the Provincial Governments do not call for any change. Forests will of course remain provincial ; and so will fisheries, which, however, can hardly be regarded a revenue-earning department. The income derived from the registration of deeds and documents will continue to be a provincial resource.

Power has been conferred by Schedule I to the Scheduled Taxes Rules on the provincial legislatures for the levy of a number of additional taxes. This power has been exercised in some provinces in regard to some of the taxes, but such exercise has not resulted in a substantial addition to their resources. The other taxes mentioned in the Schedule have not been considered quite suitable for imposition. Nor are any of these, except one, likely to bring much revenue into the provincial exchequer in future. A tax on advertisements may yield small sums in the larger towns. A tax on a specified luxury, is open to the objection that it may compete with import duties ; in any case, it is more suitable for imposition by municipalities than by a Provincial Government. So also, a tax on land put to uses other than agriculture is more fittingly a resource for local bodies than for the provincial treasury. The increment of urban land values is at present taxed by municipalities in the shape of enhanced assessments at fixed intervals. If the Provincial Governments

enter upon this sphere of taxation, the resources of local bodies will be unduly curtailed. Besides, there are likely to be practical difficulties in ascertaining, with any approach to accuracy, what increments are earned and what are not.

A considerable amount of taxation is at present levied on property changing hands at the death of the owner, in the form of stamps, and the proceeds go to the provinces. A development of this sort of taxation is provided for by schedule 1(2) to the Scheduled Taxes Rules. Taxes on succession or acquisition by survivorship are likely to be a productive resource in future. These may, on the whole, be regarded as a desirable form of taxation; but various difficulties—some of them of a practical character—have so far stood in the way of substantially increased revenues being obtained from such taxes. This source of revenue should be left in the hands of the Provincial Governments in order to secure to them the means of developing provincial subjects. The question whether inheritance taxes should belong to the Federal Governments or to the component States has given rise to much controversy in other countries.[1] They

[1] The effects of death duties are thus described in the *Report of the Committee on National Debt and Taxation* (*Great Britain*), 1927: "Special inconvenience and hardships are sometimes caused to agricultural landowners and also to private businesses, and in a minority of cases the damage done may be considerable. At the same time, with regard to businesses, it is probable that the duty, amount for amount, is rather less of a deterrent to enterprise than the Income Tax.

form a State resource in the United States[1]; but in Australia the proceeds are divided between the Commonwealth and the States. The Taxation Enquiry Committee suggest that, so long as only a probate duty is taken on a moderate scale, the present system of crediting it to the provinces should be continued; but that the question would need further consideration if a high progressive duty on the lines adopted in Europe were to be imposed. This is a matter on which no decision is needed at the present moment. Centralisation may be necessary in order to secure uniformity, but it would hardly be desirable to curtail the sphere of provincial resources. The further suggestion of the Taxation Enquiry Committee that death duties may afford a balancing factor may be left over for consideration on a future occasion.

So much for the readjustment of sources of revenue between the Central and the Provincial Governments. We now proceed to consider the re-distribution of provincial resources among the

As regards the effect on savings, we think that the Estate Duty, taking physical and psychological effects together, is distinctly more prejudicial, amount for amount, than the Income Tax; this is due partly to the nature of Estate Duty as a deferred tax, and partly to the fact that the bulk of the duty is drawn from the largest estates. ...But, whatever the effect of the Estate Duty, it is fallacious to distinguish it from the Income Tax, as coming out of the nation's capital." *Sec. IV, Sub-section VI.*

[1] Professor Seligman considers the taxation of inheritances by the States to be unsatisfactory, and suggests the method of federal administration and State apportionment.—*Essays in Taxation, Ch. XII.*

different provinces. In the future scheme of redistribution due care will have to be taken to guard against a number of errors which crept into the financial arrangements of the Montagu-Chelmsford Reforms. The injustice and the anomaly of the present system arose very largely from the fact that the distribution of revenues was not made on well-defined principles. The first thing, therefore, that is needed now is to find out a proper basis of distribution. Three possible tests may be thought of in this connexion, namely, revenue, population, and needs.

Of these, the most equitable criterion will be the total amount of revenue raised within a province. By a careful study of statistical data it will be possible to calculate, approximately, if not with a reasonable degree of accuracy, the amount of revenues, which may be said properly to belong to each province. When these estimates have been made, the distribution of resources ought to be made in such a manner that each province may get that portion of its revenues which is left over after the share of the Central Government has been deducted. As such an arrangement will be based on a sound principle, no province will have any reasonable ground for feeling aggrieved, whatever may be the amount of revenue which comes to it. It is likely, however, that the acceptance of this principle will lead to a complete change in the positions of the different provinces

in the order of allocation of resources. It may quite conceivably happen that those provinces which have received favoured treatment under the present system will find themselves in possession of much smaller revenues as the result of such a re-arrangement. But as they have already adjusted their expenditure to their existing revenues, retrenchment will be needed, which may prove harmful to the interests of the people. There being no clean slate to write upon, it will hardly be possible to ignore existing circumstances. However equitable, therefore, this criterion may be from the standpoint of pure theory, it will be difficult to adopt it in practice as the sole guiding principle for the purpose of a re-adjustment.

Population will offer another alternative test. If this basis be accepted, provinces like Bengal and the United Provinces will have substantial gains, while Bombay and Burma will lose heavily. In fact, the population test will so alter the present financial arrangements that no practical financier is likely to accept it as a criterion by itself. This test, however, should always be kept in view so as to correct the errors of any other scheme that may be decided upon.

The least satisfactory criterion is expenditure. It tends to give a premium to such provinces as have been extravagant in the past in the management of their resources and to penalise those provinces which have been unfairly treated in the

past by the Government of India or the expenditure of which has been kept down by superior orders. The only thing which can be said in favour of this test is that it has a close relation to existing facts. But the force of this argument considerably diminishes when it is remembered that these actualities themselves have been artificially and arbitrarily created. Past expenditure ought not, therefore, to be accepted as a test in distributing provincial revenues. If this factor is to be taken into consideration at all, the period with reference to which standard expenditure is to be considered will have to be fixed with great care. It seems that the average of the first three years of the reformed system would be more suitable for this purpose than any other. These were years in which additional expenditure was needed in all the provinces owing to revisions in salaries, but as provincial contributions were levied, the differences in the standards of expenditure in the different provinces were not so great as they are at the present moment.

But a variant of this criterion, namely, needs, will form a far better test than expenditure. A great deal of investigation, however, will be needed to find out the present and the future needs of the different provinces; but even then, it will be difficult to secure exact measurements.

It is thus clear that none of the three tests, if each be taken by itself, is likely to prove satisfactory. But a combination of the three criteria is likely to yield

the best results in present circumstances. Such a scheme will not perhaps give perfect satisfaction to any province; but dissatisfaction will be reduced to a minimum. It will be more free from defects than any other system, and substantial justice is likely to be done to all the provinces. This scheme may also be expected to work with the least amount of friction.

Let us now discuss what heads of revenue ought to be made over to the provinces. Two guiding principles may be laid down in this connexion. The first is, that the scheme of redistribution must be an equitable one. This is a matter of the greatest importance. So long as an imperial system existed, it did not matter much if there were some inequalities in distribution. Under such a system it was expected that, whenever a province was in trouble, the Government of India would come to its rescue. But the position is different now. When a distribution of resources is made on the basis of provincial autonomy, it is essential that every province should get its just and legitimate share. This will result in placing the various provinces on a footing of as much equality as possible. It should be borne in mind, however, that symmetry is not equality, and that apparent equality may turn out to be real inequity. To ensure substantial equality between the different provinces and to deal equitably with all of them, it

will be necessary to give due weight to the three principles mentioned above, namely, amount of revenue collected in a province, its population, and the expenditure required to meet its essential needs. In considering the revenues of a province, the mistake made by the authors of the Joint Report as well as by the Meston Committee should be avoided. They started by labelling certain heads of revenue as imperial and others as provincial. Such distinction is not only incorrect in theory, but has been found to yield extremely unfair results in practice. In considering needs, it will not do merely to calculate the existing charges, but it will be necessary to take into account all essential requirements particularly those which have been neglected in the past.

The second principle is that every province should be given some elastic and expansive sources of revenue. This principle, unfortunately, was not kept in view by either the authors of the Joint Report or the Committee on Financial Relations. But it must not be ignored on the occasion of a resettlement. The yield of each of the sources of revenue will have to be carefully worked out for each province, and the possibilities of future expansion will have to be considered.

In attempting to give effect to these principles it will perhaps be found that, if the same sources of revenue are allocated to all the provinces, there

is the likelihood of an injustice resulting to some provinces. One obvious and easy method of ensuring equity would be to give subsidies to provinces receiving inadequate resources as the result of the general distribution. While such a method would be welcome as a temporary expedient, it would be open to objection on various grounds in a scheme of permanent arrangements. There is the possibility that subsidies would be looked upon in some quarters as "doles" in another form. Such a scheme might also be considered as antagonistic to the principle of provincial autonomy.[1]

The second method would be to transfer such important heads of revenue to the provinces as would make the positions of all the Provincial Governments absolutely secure. But this might result in weakening the financial position of the Central Government, and the deficits in the central

[1] In many federal countries, however, the system of subsidies prevails. In Australia, subsidies from the Commonwealth to the States were, until 1926-27, based on an annual payment of 25*s*, *per capita*, and, in addition, a special payment was made to each of the States of Western Australia and Tasmania, half of the special payment to the former being contributed by all the States out of their *per capita* receipt of 25*s*., the other half being contributed by the Commonwealth. The system of making special grants to the States has now been substituted for the *per capita* payments. Western Australia and Tasmania receive additional assistance on account of special difficulties and disadvantages. The system of subsidies is also a feature of the German fiscal system. In Switzerland, certain functions imposed by law upon the Cantons are conditional upon grants of subsidies by the Federation.

budget would have to be met by contributions from the financially stronger provinces. Such a system was given a trial—though an unfair one—and abandoned. A reversion to it is sure again to give rise to a great deal of clamour and trouble in some of the provinces.

The last alternative would be the adoption of a system of divided heads of revenue. The objections urged against this system, as has already been shown, are not of a vital character. If the principle of divided heads be adopted, substantially equal treatment of all the provinces might be ensured by giving different proportions of such heads to the different provinces. In the new scheme some sources of revenue would be entirely central, and some others entirely provincial; while a few would be divided. Of these last, one or two would have to be used as "balancing factors" in order to correct errors or to remove any inequalities which might otherwise occur, and thus to secure adequate resources to all the provinces. The "balancing factors" would also be helpful for remedying any defects which might be found in future in the working of the system.

An indication has already been given as to which of the sources of revenue should belong exclusively to the Central Government or the Provincial Governments, and which should be divided. Import duties, salt, opium, the excise duty on petroleum and kerosene, the net profits from railways, the

receipts from currency and coinage, tributes from Indian States, and all receipts from central departments would under this scheme be retained by the Government of India. Land revenue, irrigation, stamps, excise (with the exception of the income derived from opium and locally manufactured foreign liquor), registration fees, and the taxes mentioned in Schedule I to the Scheduled Taxes Rules, would belong to the provinces. Income-tax would be divided between the Central and Provincial Governments. Export duties and the revenue derived from locally-manufactured foreign liquor and from opium vends would be under the control of the Government of India, but used as "balancing factors."

The adoption of the scheme outlined above would result in an augmentation of the resources of the Provincial Governments. The question now is, Where would the additional funds come from? There are two ways in which funds can be secured,—first, by retrenchment in the budget of the Government of India, and second, by extra taxation. It need hardly be said that the first would be the more desirable method, and it has already been shown that it would not be impracticable. If the whole amount required for the purpose of this scheme be not immediately available by means of retrenchment, partial effect may be given to the scheme just at the present moment. The normal growth of revenues conse-

quent upon the revival of trade and industry is sure to place larger resources at the disposal of the Government of India in the not very distant future. But no mere temporary adjustments will offer a solution of the problem. The scheme should be framed in such a way that the whole of it may come into effect within a reasonable period, say ten years, and, in the meantime, the grievances of individual provinces may be redressed as far as possible. For instance, varying proportions of the income-tax may be made over to the different provinces during the period of transition.

Such a method is to be preferred to that of fresh taxation, for any addition to the existing burden of the people is likely to provoke discontent and thus militate against the success of the new scheme of redistribution. It should always be borne in mind that India is a country where great caution should be observed in making experiments in taxation. In case, however, additional taxation be found absolutely unavoidable, the new taxes should be selected with anxious care and forethought so that the additional burden may not press unduly upon any class of the population.

Looked at from the purely theoretical standpoint, direct taxes seem to be more just and equitable than indirect taxes. But, in India, circumstances are such that it would be extremely difficult to raise a substantial amount of additional

revenue by means of direct taxation alone. A well-thought-out scheme in which direct and indirect taxes are judiciously combined would, therefore, have to be devised. The Taxation Enquiry Committee devote some attention to the question of fresh taxes which may be levied in future. Their suggestions should be given careful consideration, although it may not be possible or desirable to give effect to all of them in this connexion.

The suggestion of the majority of the Committee regarding the imposition of an export duty on oil-seeds is a sound one, and may be accepted. An excise duty on aerated waters would be an unobjectionable way of raising revenue, but how far it would be productive is a matter of doubt. An excise duty on patent medicines, accompanied by the application of a similar duty to imported patent medicines, is regarded by the Committee as a suitable form of taxation; but whether or not such a duty would be regarded as unobjectionable by the public is not quite clear. There can be no objection to an excise duty on locally-made cigarettes and pipe tobacco accompanied by a higher rate of customs duty on imported cigars and cigarettes. But country tobacco does not seem to be a suitable subject for taxation. Apart from the practical difficulty of imposing such a tax, it is sure to be resented by the masses of the population. Tobacco has by long habit become one of the conventional necessaries for the poorer

sections of the community, and to tax this article would be to increase appreciably the burden on their shoulders.

A moderate increase of income-tax in the rates applicable to incomes above Rs. 10,000 is regarded by the Committee as equitable. In case of necessity, this suggestion as well as the suggestion regarding the levy of a new rate of super-tax of 6 pies in the rupee on incomes from Rs. 30,000 to Rs. 50,000, may be accepted. Nor should there be any serious objection to the suggestion that the super-tax on companies should be converted into a corporation profits tax and the exemption of the first Rs. 50,000 be removed. Death duties have become an important feature of the tax systems of almost all the advanced nations of the world. In India, however, there are practical difficulties in the way of inheritance taxes being levied. But, as is pointed out by the Taxation Enquiry Committee, a death duty on the lines of the English Estate Duty would be an equitable form of taxation. Such a tax, however, ought to be left over for future development after due consideration of the various aspects of the question. The extension of the income-tax to landed incomes would not in itself be a wrong method of raising additional revenue, but it would be desirable to take up this question independently, instead of as part of a scheme of redistribution of resources.

A few more taxes may be thought of in addition to those considered by the Taxation Enquiry Committee. The import tariff may easily bear small additions in some cases; for instance, the duty on imported cotton goods may be raised to 15 per cent., which is the general rate. Although an increase has recently been made in the excise duty on petroleum for the purpose of road development, a small further addition is not likely to cause much hardship. Lastly, a duty on the private imports of silver would be a legitimate source of income. Such a duty would, on the one hand, tend to appreciate the savings of the poor in the shape of ornaments, and, on the other, discourage the habit of hoarding. If a duty on silver be levied at 10 per cent., a sum of a crore of rupees may be obtained without causing hardship on anybody.

The science of public finance has made a rapid progress in recent years. But in no sphere has its advance been more marked than in its efforts to attain the ideal of justice. It is necessary that an earnest and sincere attempt should be made to realise this ideal in the financial relations of this country. Time has come when the inequalities and inconsistencies of the present system must be ended and the entire financial structure of India based on principles of equity and fairness.

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